The University of Liverpool

Management School

An Empirical Investigation of the Libyan Audit Market: Perceptions of Auditor Independence and Perceived Reliability of Audited Financial Statements

Thesis submitted in accordance with the requirements of the University of Liverpool for the degree of Doctor of Philosophy

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List of Abbreviations

AC: Audit Committee

AICPA: American Institute of Certified Public Accountants

APB: Auditing Practice Board

ASB: Accounting Standards Board

Big 4 auditors: PricewaterhouseCoopers; Ernst & Young; KPMG, and Deloitte & Touché.

CBL: Central Bank of Libya

FASB: Financial Accounting Standards Board

GAAP: Generally Accepted Accounting Principles.

GAI: General Authority for Information (Libya)

GAO: Government Accountability Office (USA)

GPC: General People Committee (Executive Government in Libya)

GPCO: General People Congress (Parliament in Libya)

IASs: International Accounting Standards

ICAEW: Institute of Chartered Accountants in England and Wales

IFA: Institute of Financial Auditing (Libyan government-affiliated organisation)

IFAC: International Federation of Accountants

IFRS: International Financial Reporting Standards

IMF: International Monetary Fund

IPC: Institute of Public Control (Libyan government affiliated oversight organization)

ISA: International Standards on Auditing

LAAA: Libyan Accountants & Auditors Association

LCC: Libyan Commercial Code

LFB: Libyan Foreign Bank

LIA: Libyan Investment Authority

NAS: Non-Audit Services (e.g. accounting system design, accounting-related advisory etc)

OILMAs: Owners, Investors, Lenders, Managers and Auditors

PAI: Perceived Auditor Independence

RAFS: Reliability of Audited Financial Statements

SOX: Sarbanes Oxley Act (US Act enacted on the aftermath of Enron Collapse on 2002)

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Declaration

I hereby declare that I am the author of this thesis; that the work of which this thesis is a record has been done by me, and that it has not previously been accepted for a higher degree. However, some parts of this thesis have been published in co-authorship with Dr. Saeed Akbar in the following papers:

Faraj, S., and Akbar, S. (2009) 'Perceived Reliability of Audited Financial Statements: The Case of Libya' In: eds. *British Accounting Association Annual Conference, 21-23 April, 2009.* The British Accounting Association Annual Conference, University of Dundee. Dundee: British Accounting Association, pp.1-33.

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Akbar, S., and Faraj, S. (2008) 'An Empirical Investigation of the Auditor's Independence in Libya'. In: AGBA eds. *'Proceedings of the First South Asian International Conference'*, First South Asian International Conference on Globalization and Change', Peal Continental Hotel, Bhurban. Islamabad: AGBA, pp.1-26.

S.M.F

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Shamsaddeen Faraj (2009)

Dedication

I dedicate this work to my parents.

Abstract

Auditor independence is an important issue which has received considerable attention since the collapse of Enron, WorldCom and Sunbeam in 2002 and Lehman Brothers in 2008 in the USA; Bank of Credit and Commerce International in 1991; One.Tel in Australia in 2001; and Satyam in India in 2009. In the corporate world, the importance of this topic comes from the fact that independently-audited financial statements may result in the generation of true and fair accounting information which will enable and assist stakeholders to form rational expectations about firms. It will also result in minimising the agency cost and mitigating the agency problem (asymmetric information between principals and agents due to remoteness gap). Thus auditors are expected to monitor the agency relationship as outlined by the agency theory. However, a lack of independence would lead auditors, who audit financial statements, to collaborate with firms' managers who prepare these financial statements. Consequently reliability of these audited financial statements would be threatened.

Financial statements assist investors in making rational financial decisions if they are reliable. The reliability of audited financial statements is based, in part, on the nature and quality of an independent audit. The review of the relevant literature reports mixed results. It also suggests that the bulk of research is conducted within developed countries, while little effort is directed to developing countries. This study, therefore, examines the effects of eight variables which may impact on the independence of auditors and consequently affect the reliability of financial statements. These variables include: audit firm size, audit fee size, audit tenure, audit committee, non-audit services, competition, legal incentives and socio-cultural relationships. 400 questionnaires were distributed to 5 groups which included owners, investors, lenders, managers and auditors in Libya as a typical developing country. Semi-structured interviews including 16 respondents were also conducted to complement and enhance the questionnaire survey results.

The results reveal that users consider auditor independence as an important ground for reliable financial statements on which they base their decisions. These results highlight the fact that amongst other variables, the non-availability of auditing standards in Libya is one of the strongest influences undermining auditor independence. The results also suggest that across the sub-groups in the sample there are differences in the relative importance of the variables under study. In addition, nonparametric tests reveal that these factors have significant impact on the perceived reliability of audited financial statements. Furthermore, Factor Analysis illustrates the interrelationship between all variables under investigation. More specifically, the results suggest that economic, regulatory and country-specific-culture have an impact on the auditor's independence and the perceived reliability of audited financial statements.

These results would be useful input for LAAA in developing the accounting profession and in standards-setting process. The results are also useful input for the IFAC process in harmonising global accounting and auditing standards. Current users and potential investors (both local and foreign) may benefit from these findings so as to be aware and familiar with the characteristics of the Libyan audit market and its underlying culture.

Chapter 1

Introduction

1.1 Introduction

The purpose of an audit is to assure and assist users to rely more heavily upon the accounting information which has already been prepared by others Dunn (1996). An independent auditor is expected to monitor and verify accounting information presented by management, on behalf of an entity's owners. The agency theory outlines the contractual relationships between the principals and agents, and these two parties are involved in a relationship with diverse incentives (self-interest) that pose conflicts of interest. An independent auditor is appointed to monitor this relationship and mitigate the agency cost. In addition, the appointment of an independent auditor creates a further agency relationship between the auditors and the appointing party (management). The managers may exploit their economic power (pay and hire) to exert pressure on auditors; therefore, collaboration between managers and auditors may occur. If such collaboration were to exist, the monitoring function of an auditor would be of no value (Watts and Zimmerman, 1986).

An independent auditor could, therefore, play a very important role in minimising the agency cost. Similarly, independent audits are monitoring mechanisms which enhance the credibility and reliability of financial statements on which users of these statements make rational decisions. These decisions, whether investment or lending, are therefore influenced by the reliability of these audited financial statements (Stettler, 1970 and Nelson et al., 2008). However, the recent corporate failure of Enron, Sunbeam, and WorldCom in the USA (Cullinan, 2004); Bank of Credit and Commerce International (Cousins et al., 1999); One.Tel in Australia (Walker, 2004) and Satyam Computers in India (Sapovadia and Patel, 2009) have brought the independent audit into question. This study, therefore, aims to examine certain factors that may be perceived to undermine auditor independence as well as those strategies that may safeguard auditor independence and perceived reliability of financial statements audited by independent auditors.

Auditor independence can be considered in terms of two facets: actual independence and independence in appearance[1]. The former refers to an unbiased mental attitude of the auditor, while the latter refers to the perceptions of third parties who observe that the auditor is free from the influence (relationships) of the audit client (AICPA, 1993). Furthermore, the IFAC (2007) requires both independence of mind (actual) and independence in appearance.

Auditor independence was slow to develop in the UK and in the USA. In the mid nineteenth century, auditors were required by law to hold shares in the audited entity. In the late nineteenth century in the UK, legislation permitted auditors to hold shares in the client company. However, in 1962, the AICPA prohibited such auditor-shareholdings in the USA. Similarly, in 1979 in the UK, auditors were prohibited from holding shares (Kilcommins, 1997). In addition, Watts and Zimmerman (1983, p: 633) argue that "*the existence of the independent auditor is not the direct result of government fiat. The appearance of the professional independent auditor was encouraged by changes in UK bankruptcy laws, but the United States' evidence suggests that even without those bankruptcy laws, economies of scale in auditing would have led to the development of the professional independent auditor.*"

Furthermore, it has also been argued that auditor independence issues, which are based on the perception that allowing auditors to provide non-audit services for audit clients, present the greatest potential for conflict (Cosserat and Rodda, 2009). With the start of the 21st century, the US enacted the Sarbanes-Oxley Act SOX 2002 Act as a response to the Enron collapse. This law prohibits the provision of certain types of non-audit services to audit clients. The SOX act also requires a mandatory audit partner rotation after 5 consecutive years of providing audit services to audit clients. However, the accounting profession in the USA opposes the proposal of audit firm rotation, as SOX requires a survey to investigate the expected benefit and cost of an audit firm rotation.

However, the United Kingdom has not followed the USA example regarding the prohibition of non-audit services, but rather has imposed rules for tighter control over, and transparency of, the provision of non-audit services to audit clients (Cosserat and Rodda, 2009). In addition, in the UK, the Auditing Practices Board (APB) was

[1] This research is concerned with this concept of auditor independence (independence in appearance) rather than actual independence which is not observable by other users.

established. The APB in 2004 issued guidelines which regulate the limit of audit firms' gross income as that of not exceeding 10 percent from one client successively or not exceeding 15 percent from a non-listed client company (APB, 2004). Moreover, the UK (ICAEW, 2002)[2] requires audit partners to rotate every seven years. The remainder of this chapter is organised as follows: the problem of auditor independence, followed by a brief outline of the objectives and methodology of this study with the final section providing an outline of the thesis.

1.2 The Research Problem

In the corporate world, the importance of auditor independence comes from the fact that independently-audited financial statements may result in the generation of true and fair accounting information which enables and assists stakeholders to form rational expectations about firms (McEnroe and Martens, 2001). Similarly, Higson (1997) argues that the view that financial statements enable users to assess the future, judge the past, take decisions, assess stewardship and judge performance represents an expectation gap. Moreover the widening of the expectation gap, the gap between what users expect and what is required from auditors, has resulted in a challenging criticism to the audit function (Dixon et al., 2006). In addition, the collapse of Enron has also brought the auditor's independence into question. The Enron scandal was due to the fact that Arthur Andersen (Enron's auditor) collaborated with Enron managers at the owners' and shareholders' expenses (Francis, 2004 and Kiabel et al., 2009). This high profile corporate demise resulted in the US congress enacting a new law[3] for the purpose of restoring public confidence in the auditor's independence and the reliability of audited financial statements.

Reliability of audited financial statements is fundamental for companies. This is due to the fact that investors' confidence is based on these statements (Stettler, 1970 and Nelson et al., 2008). Furthermore, an audit's monitoring mechanism enhances the reliability of financial statements. The reliability of audited financial statements is dependent, in part, on the auditor's independence (Pany and Reckers, 1988; Kilcommins, 1997; Shafer et al., 1999; Huang, et al., 2007 and Jennings et al., 2008).

[2] See page (71) for more details about the rotation's regulatory requirements in the UK.
[3] SOX 2002 Act which prohibits certain types of non-audit services to audit clients, and requires a 5-year audit partner rotation (SOX, 2002).

However, the recent[4] global financial crisis seems to have affected the perceived reliability of audited financial statements. For instance, Lehman Brothers received an unqualified audit report from one of the Big 4 audit firms (Ernst and Young). The financial statements of Lehman Brothers mention derivatives contracts with a face value of $738 billion and fair value of $36.8 billion. Despite the extended financial crisis, Lehman's auditors did not express any suspicions about the value of the derivatives or any situation under which the company may be unable to meet its obligations. Just two months later, Lehman collapsed (Sikka, 2008). This raises the question about competence and independence of Lehman's auditors. Moreover, it has been argued by Hodge (2003, p: 46) that '*perceived earnings quality for publicly traded firms has declined over time, as has perceived auditor independence and the perceived reliability of audited financial statements*'.

In can be argued that a lack of independence would lead auditors to collaborate with the management of firms and produce accounting information that may be misleading for stakeholders (Watts and Zimmerman, 1986). On this basis, it is fundamental to establish what factors are perceived to impair auditor independence and consequently decrease or threaten perceived reliability of audited financial statements. This study also aims to explore what strategies may safeguard the independent audit. Therefore this study aims to answer the following question: what are the perceptions of auditor independence as perceived by owners, investors, lenders, managers and auditors within a developing country (Libya)? In addition, what is the perceived reliability of audited financial statements in making business decisions among these groups?

1.3 The Objectives of the Study

The research is concerned with the perceptions of external auditor independence, held within the Libyan context as an emerging market. In this regard, Beattie et al. (1998 and 1999b) argue that auditors provide assurance to investors on the reliability of companies' financial statements and help to reduce the cost of capital. Capital markets therefore, rely in part on the integrity and independence of the auditors. This study seeks to obtain an empirical evidence for the first time by a questionnaire survey which is complemented by semi-structured interviews. This study also intends to provide both descriptive and analytically derived insights as to the perceptions of

[4] The US financial crisis, which become a global one in September 2008, while this research is current.

auditor independence and the perceived reliability of audited financial statements within the Libyan context.

More specifically, the objectives of this research are: (1) to examine the effect of eight selected factors on perceptions of auditor independence held by owners, investors, lenders, managers and auditors (OILMAs[5] hereafter) in Libya; (2) to examine the effects of these perceptions on the perceived reliability of audited financial statements (RAFS hereafter); (3) to investigate what factor(s) is/are the most important that affect(s) the perceived auditor independence; (4) to examine whether or not there is a consensus among OILMAs' perceived auditor independence (PAI hereafter); and (5) to examine the interrelationships between these factors. The eight selected factors for investigation, which are discussed in detail in chapter 3, are: audit firm size, audit fees size, audit market competition, providing non-audit services, socio-cultural relationships, audit committee, audit tenure and legal incentives. These factors were selected for the reasons outlined below.

Firstly, despite the fact that the effects of each of these factors have been examined in previous studies in developed countries (e.g. Porter and Gendall, 1998; Beattie et al., 1999a; Canning and Gwilliam, 1999; Abbott et al., 2000; Abbott and Parker, 2000; Craswell et al., 2002; DeFond et al., 2002; Carcello and Neal, 2003; Quick and Warming-Rasmussen, 2005; Hay et al., 2006; Gates et al., 2007; Stewart and Munro, 2007; and Mangena and Tauringana, 2008), little research has been conducted on these issues within developing countries (e.g. Sabri, 1993; Teoh and Lim, 1996; Al-Twaijry et al., 2002; Rutledge et al., 2003; Al-Mudhaki and Joshi, 2004; Joshi and Wakil, 2004; Ahmed and Goyal, 2005; Abu Bakar et al., 2005; Alleyne et al., 2006; Joshi et al., 2007; Habib and Islam, 2007; and Salehi, 2009).

Secondly, the previous studies have neglected the influence of country-specific national culture on the perceived auditor independence and the perceived reliability of audited financial statements. Finally, no previous Libyan study of this nature has been undertaken. This study's second objective entails an assessment of whether or not the existence of each of these variables leads to financial statements being perceived as more or less reliable. For the purpose of this study, reliability is defined as the quality of information which assures that information is reasonably free from

[5] The characteristics of each group are described in chapter 4 (population section).

error or bias and truly and fairly represents what it asserts to represent (FASB, 2004). The review of the relevant literature (chapter 3) reveals that there is no empirical evidence that links the auditor independence with the reliability of audited financial statements within developing countries; therefore, this study seeks to reduce this gap in the literature. The third and fourth objectives are concerned with shedding light on the results obtained from the first two lines of inquiry by investigating further into these factors to identify which factor is the most influential one on the perceived auditor independence; and by examining whether a consensus between the OILMAs' PAI exists. The fifth objective is concerned with investigating the interrelationship between these factors which are addressed in chapter three. This research concentrates on five groups: owners, investors, lenders, managers and auditors. These groups are selected because they are recognised and considered by the ASB (1991) as significant users of financial statements.

1.4 Research Methodology

The review of the relevant literature reveals a number of methods that might be employed to investigate the perceptions of auditor independence and the perceived reliability of audited financial statements. These methods include quantitative and qualitative, for instance, mail questionnaire surveys, structured and semi-structured interviews, and empirical experiments including mathematical models. These different methodologies, being used in previous studies, indicate that both quantitative and qualitative techniques can be used in examining the perceived auditor independence and the perceived reliability of audited financial statements. However, there are advantages and disadvantages which are related to each method. Punch (2000) argues that neither approach is better than the other, both (quantitative and qualitative) are needed, and both have their strengths and weaknesses. In this regard Kilcommins (1997) suggests that studies which only adopt one method are more exposed to errors related to that particular method than studies which use multiple methods in which different types of data provide cross validity checks. This study adopts mixed methods (quantitative and qualitative approaches).

To achieve the study objectives, a comprehensive review of the literature on the subject of auditor independence in both developed and developing countries was conducted. For instance, in terms of the effect of the audit firm's size on the perceived independence, the relevant literature reports conflicting results (e.g.

Shokley, 1981; Gul, 1989; Gul, 1991; Abu Bakar et al., 2005; and Alleyne et al., 2006) and argues that large audit firms with more clients are perceived to be more independent than small audit firms. However Niemi (2004) suggests the contrary, by arguing that small audit firms with large billing rates are likely to protect their reputation by supplying high quality audits. Meanwhile others (Firth, 1980; DeAngelo, 1981a; Pany and Reckers, 1980; Craswell et al., 2002; and DeFond et al., 2002) conclude that audit fee size has no effect on the perceived auditor independence. However, further research (Gul, 1991; Gul and Tsui, 1992; Bartlett, 1993; Teoh and Lim, 1996; Patel and Psaros, 2000; Rutledge et al., 2003; Abu Bakar et al., 2005; and Alleyne et al., 2006) concludes that larger proportions of audit fees, from one audit client, in relation to total audit revenue, is perceived to impair auditor's independence. Whereas Ahmed and Goyal (2005) state that subsidiaries of multinational corporations pay higher audit fees to the auditors of Big 4 audit firms, for perceived higher quality audit services in the South Asian audit market.

Audit market competition may influence auditor independence. In this regard, it has been argued that competition has no effect on the perceived auditor independence (e.g. Knapp, 1985; Gul and Tsui, 1992; DeAngelo, 1981a). However Gul (1989) argues that a high competitive audit market is even enhancing the auditor's independence. Some (for example Shockley, 1981; Shockley, 1982; Patel and Psaros, 2000; Abu Bakar et al., 2005; and Alleyne et al., 2006) argue that high audit competition increases the risk that auditor independence may become impaired, especially within unregulated developing audit markets. In this respect, it has been concluded that national laws play a major role in regulating and safeguarding the auditor's independence (e.g. Trompeter, 1994; Shafer et al., 1999; Favere-Marchesi, 2000; Tahinakis and Mylonakis, 2005). However, Wahdan et al. (2005) conclude that a lack of enforcement of regulatory requirements creates an expectation audit gap between legislation and the practise of the profession regarding its organisation and compliance with accounting and auditing standards in Egypt which represents a developing audit market.

Audit markets in developed countries, nevertheless, seem to be more regulated than those in developing ones. For instance, the audit committee plays a major role which is perceived to reduce the audit risk and enhance audit quality (e.g. Knapp, 1987; Porter and Gendall, 1998; Abbott et al., 2000; Abbott and Parker, 2000; Carcello and

Neal, 2003; Joshi and Wakil, 2004; Pandit et al., 2006; Stewart and Munro, 2007; Mangena and Tauringana, 2008). However, Al-Twaijry et al., (2002) conclude that audit committees in Saudi Arabia do not have the power to protect shareholders nor are they able to enhance the role of external auditors. In addition, it is concluded that rotating audit firms is perceived to enhance auditor independence (Abu Bakar et al., 2005; Gates et al., 2007; Alleyne et al., 2006; Jennings et al., 2006; and Abdul Nasser et al., 2006). However, others (for example Ghosh and Moon, 2005; and Kaplan and Mauldin, 2008) conclude that audited financial statements are perceived as more reliable for firms with longer auditor tenure. While Firth, (1981) and others (Shockley, 1981; Teoh and Lim, 1996) argue that a non rotating audit firm (a long association between the auditors and their clients) is not perceived to impact on the auditor's independence.

Moreover, Hofstede's (1980) wide-ranging work on the consequences of cultural differences across nations, confirms substantial variation in certain predispositions to particular phenomena, a fact that inevitably has impacts on practises in finance and accounting. Thus, national cultures impact on the accounting profession and the auditor's independence across countries or regions, (e.g. Patel and Psaros, 2000; Patel et al., 2002; Rutledge et al., 2003 Askary, 2006; Gendron et al., 2006; Kosmala, 2007; and Askary et al., 2008). In addition, Retchie and Khorwatt (2007) argue that the auditing profession in Libya is influenced by cultural values of family, tribe and community.

Therefore, it can be concluded that the review of relevant literature reports mixed results concerning the issue of auditor independence and its impact on the reliability of financial statements. It can also be argued that the problem of the auditor independence has not yet been solved. Therefore, it is believed that this topic is worth investigation in this study within a developing audit market in Libya. At this stage, the researcher concludes that there are eight factors which may potentially affect the perceived auditor independence and the perceived reliability of audited financial statements. Based on the understanding of the effects of these factors, the process of developing a questionnaire, which is discussed in detail in chapter four, was undertaken. Therefore, three stages of the data collection process were considered essential to achieve the goal of the study. The first stage of the data collection process

entailed a pilot study in the Libyan audit market as to explore the nature of this environment. This has resulted in the researcher discovering that most banking and commercial activities are run in the capital Tripoli. Informal discussions and phone calls were also conducted with senior officers in the Central Bank of Libya and other commercial banks. Informal meetings were held with managers and owners of private companies. Several visits to the headquarters of the Libyan Accountants and Auditors Association LAAA were conducted in order to collect initial information about external auditors who perform their services in the capital, Tripoli.

The second stage was the administration of a questionnaire survey to owners, investors, managers of private companies, lenders and external auditors including the Big 4 auditors' partners and correspondences. The third stage involved semi-structured interviews. These interviews were conducted after the completion of the second stage and analysis of the questionnaire survey. These actions helped to obtain sufficient empirical data to answer the research question and fulfill the research objectives.

1.5 Significance of the Research

The importance of auditor independence has been recognised by academic and professional bodies. For instance, a huge body of literature documents empirical results which are originated from developed countries. Moreover, professional bodies in the USA are concerned with the auditor independence reform, for instance the SOX 2002 Act. However, the review of the relevant literature reveals that there seems to be little effort directed towards perceptions of auditor independence in developing countries. In addition, a review of literature leads to the conclusion that the influence of country-specific culture, on the perceived auditor independence, is also neglected. In this vein Tsui and Windsor (2001) argue that future research is needed to investigate the influence of diverse culture on auditors' attitude and independence. Similarly it has been argued by Tahinakis and Mylonakis (2005) that there is a need for further investigation in the area of non-audit services.

Moreover, Catanach and Walker, (1999) and Ghosh and Moon, (2005) argue that there is a need for further research to examine the effect of audit tenure on audit quality. Furthermore, Fearnley and Beattie (2004, p: 118) argue that '*the collapse of Enron in 2001 and the WorldCom scandal provided evidence of systematic failure in*

the US regulatory framework for financial reporting. Enron meltdown raised prevalent beliefs that Andersen had compromised its independence as auditors'. Similarly, it has been argued by Gavious (2007) that the revelations of massive corporate scandals have proved that the existing rules requiring auditors' independence to be inadequate. In addition, academics and regulators are keen to uncover local audit market characteristics for the purpose of the global harmonisation of the international accounting and auditing profession. Thus, this study seeks to reduce this gap in auditor-independence literature. Therefore, this research is devoted to investigate the perceived auditor independence and the perceived reliability of audited financial statements in Libya[6]. It is hopeful that the results of this study will help regulators and policy makers in the harmonisation of the global accounting profession. The study results are also expected to help the LAAA in the development of the local accounting and auditing profession. The results will also be of great assistance to foreign investors.

Moreover, this study is deemed to explore the factors that may threaten auditor independence and those strategies which may safeguard it. This study is therefore expected to contribute to the body of knowledge and enrich understanding of the issues that might influence the perceived auditor independence and the perceived reliability of audited financial statements. This is from a wider perspective that involves various issues such as the influence of country-specific culture on the perceptions of auditor independence among other factors from the view point of five groups of major users of financial statements within a developing country. This study is also expected to reduce the gap in the literature of auditor independence in developing countries. In this vein, Wood (1996) and Hudaib and Haniffa (2009) urge for further research to explore the effects of cultural aspects on the perceived independence and hence the perceived reliability of audited financial statements.

1.6 Organisation of the Thesis

The overall structure of this thesis is shown in figure 1.1. It is divided into eight chapters. The first chapter provides a background to the research problem, and it highlights the objectives of the study. The first chapter also presents a brief description about the methodology used in this research. It also discusses the

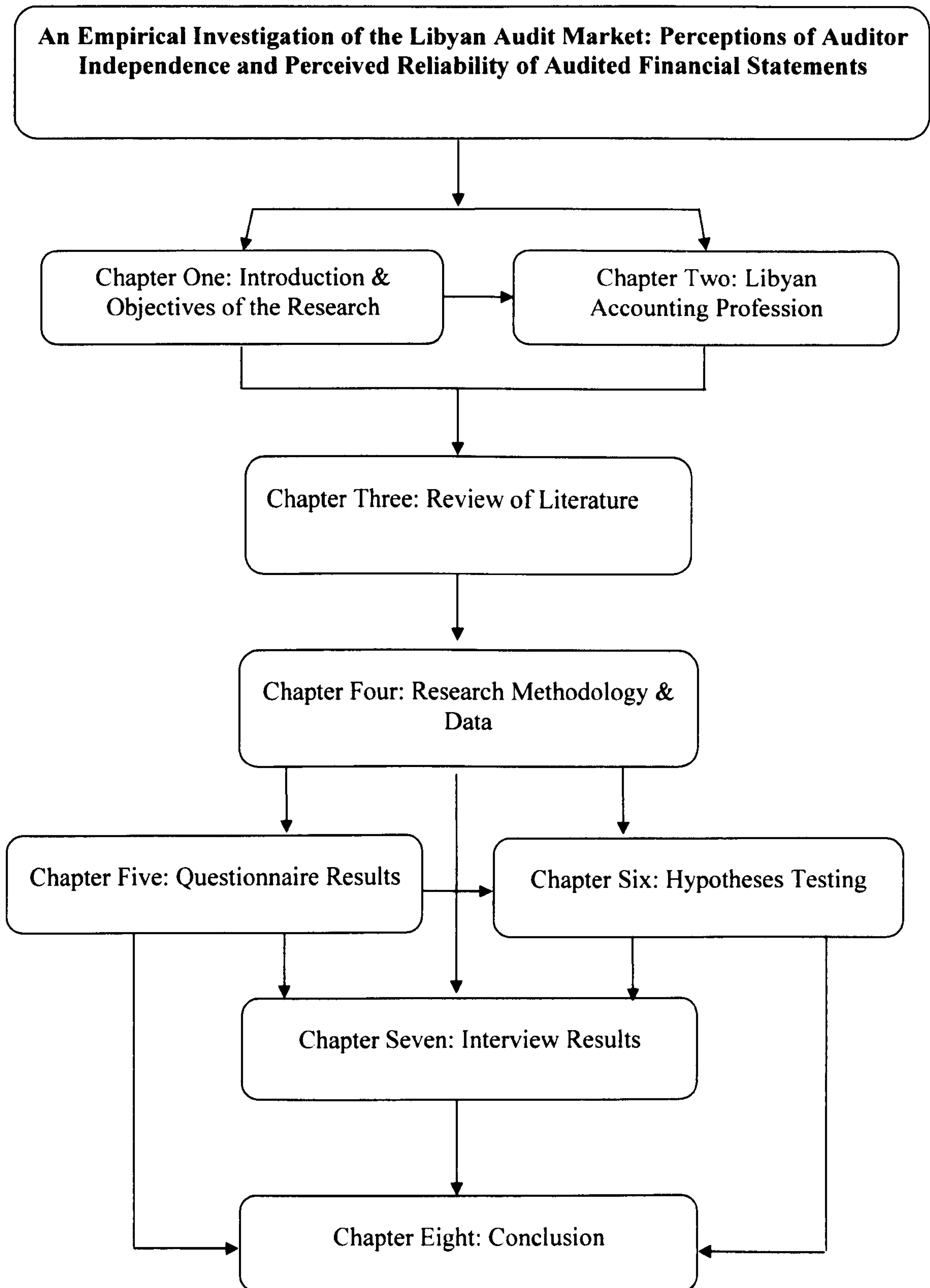
[6] For more details about this country's accounting profession see chapter 2.

rationale behind this study and illustrates the outline of this thesis. Chapter two is assigned to provide a brief descriptive background about Libya where the field study took place. It discusses the development of the accounting profession in Libya, and presents some economic indicators and cultural background about the country. Chapter three is concerned with a discussion of the concept and nature of auditor independence. It also discusses the agency theory which is underpinning this research study and examines the research literature relevant to auditor independence and the reliability of financial statements in both developed and developing countries. Chapter 3 also outlines the studies undertaken within this context and is concerned with those issues which may potentially affect the auditor independence in appearance. These issues are: audit firm size, audit fees size, non-audit services, audit market competition, country-specific culture, legal and institutional incentives, audit committee, and audit tenure. Chapter three also aims to determine the current level of knowledge and understanding of the relevant issues and to draw attention to the contribution of this study to the existing body of knowledge. Chapter three also develops the hypotheses of this thesis.

Chapter four addresses the research methodology employed for this current research. It also provides a discussion of the research design, questionnaire development and administration and the procedures used in conducting the interview survey. In addition, chapter four illustrates the three stages of data collection. They are namely: the pilot testing, questionnaire survey administration and the conduct of a semi-structured interview survey. Chapter five provides a descriptive analysis of the data collected by the questionnaire survey. Chapter six is devoted to address statistical analysis to test the research hypotheses. Chapter seven discusses the analysis of the interview survey. The last chapter is devoted to a summary of this study and draws conclusions and addresses the limitations of the study and provides recommendations and avenues for future research.

This chapter outlines the contents of the thesis. It highlights the research problem and explains the significance of, and motives behind, conducting the study. It also highlights the objectives that this study aims to achieve, followed by an outline of the research methodology adopted in this study. The following chapter is devoted to a discussion of the background of a North African country (Libya) where this field study took place.

Figure 1.1 Outline of Thesis



Chapter 2

The Libyan Accounting Profession

2.1 Introduction

The preceding chapter emphasised the importance of the auditor independence and the reliability of audited financial statements, and outlined the objectives of this thesis. Since the main purpose of this research is to investigate the perceptions of auditor independence and the perceived reliability of audited financial statements in Libya, this chapter aims to discuss the main characteristics of the Libyan audit market wherein the chosen major users of audited financial statements operate. The rationale behind discussing the Libyan audit market is that the bulk of previous empirical research has been conducted within developed countries, which existed since the 1960s (Schulte, 1965 cited in Beattie et al., 1999a). However, little research has been directed towards investigating the perceptions of auditor independence within developing countries.

Although there is a number of studies which came from developing countries such as Teoh and Lim (1996) and Abu Bakar et al., (2005) in Malaysia; Al-Mudhaki and Joshi (2004) in India and Awadallah (2006) in Egypt, these studies focus on a limited number of factors that may influence an auditor's independence. However, the influence of country-specific culture and its underlying values on the issue of audit independence seems to be neglected. Thus, this research aims to reduce this gap in the literature concerning perceptions of auditor independence and perceived reliability of audited financial statements. This chapter is organised as follows. The second section highlights the location of Libya, followed by a discussion of the Libyan culture. The fourth section addresses a brief discussion about the Libyan economy, followed by an outline of the Libyan financial sector. The sixth section sheds light on the accounting profession in Libya, followed by an outline of Accounting Standards in Libya.

2.2 The Location of Libya

Libya is located in North Africa, which lies on the south coast of the Mediterranean Sea with a coastline of about 1900 kilometres. The country has frontiers with six

Arabic and African countries: Algeria and Tunisia on the west, Egypt on the east, Sudan on the southeast, and Chad and Niger on the south. The country has a small population of about 5.3 million residents occupying, relatively, a very large area, about 1.7 million square kilometres. It is ranked the fourth largest in terms of area size among African countries, and it is the 17th largest in the world (GAI, 2007). In addition, the capital is Tripoli, which is home to 1.004406 million of Libya's 5.3 million people who share a similar culture.

2.3 The Libyan Culture

According to Hofstede (1980), Libya has been portrayed as highly masculine and uncertainty-avoidant with a large power distance and collectivistic society (low individualism). In this vein, Abubaker (2007) argues that Libyan culture is considered to be a traditional culture, and Libyan society consists of large tribes and extended families which might be as a result of the influence of the religion of Islam. Islam also requires society to establish strong extended family relationships. However, in the Libyan society, individuals and employees in their organisations adhere to societal values such as the reputation of their names, families and tribes. Therefore, social reputation is a very important element for societal relationships in Libyan society (Twati and Gammack, 2006). Moreover, close Libyan social relationships are derived from Islam.

Islam is the main religion of Libyan society which comprises extended family and tribes, where national culture, values and norms have their influence in all aspects of everyday life, including accounting and auditing services. In terms of cultural classification, Libya is classified as one collectivistic community (Hofstede, 1980). According to Hofstede (1980, 1997) there are five dimensions of cultural values[7]. In addition, the socio-cultural structure in Libya is embedded in the political system (Popular Leaderships which is an informal association) which consists of those senior leaders of all Libyan tribes (Pargeter, 2006). This is along with the General People Committee which is the highest executive body in Libya.

Libya, however, is still experiencing real limitations to a development model based on its current administrative system that aims to enforce the rule of law in the country. Over the last few years, Libyan officials have become expert in brandishing terms

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[7] For more details see chapter 3 section 3.11

such as accountability, diversification, partnership, and transparency. However, the reality on the ground is a reform process implemented in an ad hoc, opaque manner with its pace and effectiveness compromised by human capacity constraints (John, 2007). Thus one could argue that human capacity constraints could slow down the expected growth of the Libyan economy which has recently witnessed a new era of transformation. The following subsection addresses brief highlights about the Libyan economy.

2.4 Libyan Economy

The Libyan economy has long been dependent on oil production. The oil industry accounts for the main import and GDP in the country (Al-Gathafi, 2005). In the same regard, Ekhlat et al. (2007) reported that oil and natural gas are the main sources of income in Libya. Libya's oil export revenues have increased sharply in recent years to $34 billion by the end of 2006 up from only $5.3 billion in 2001. Libya's oil export revenue represents 90 per cent of the total revenue; Tables 2.1 and 2.2 portray the growth of oil exports in Libya over the last 5 years. Moreover, Libya is an important oil country to European countries. Libya recently adopted a series of measures[8] to reform its economy and consequently its financial sector.

The Libyan government established the Libyan Investment Authority (LIA) in March 2007. This body was founded to invest the LIA's initial $40-50 billion on a commercial basis and ensure that the LIA will be run by a qualified and independent management. However, lack of transparent procedures regarding large withdrawals from the LIA under exceptional circumstances remains an obstacle in the financial reform process (IMF, 2008b). Moreover, regarding the audit of the LIA's fund, Law No. 11 for 1995: Article 11, states that 'the Institute of Financial Auditing (state-affiliated audit organisation) is assigned to make such an audit as agreed between the IFA and the LIA's management (Otman and Karlberg, 2007). It could be observed from Law 11 that it has neglected the external auditors and instead limiting the audit work to government-affiliated and nominated organisation. Therefore, it can be concluded that the LIA is not subject to an external independent audit.

[8]Libya witnessed an economic reform and deregulations since 1990s. This restructure include the privatization of some state-owned companies. For instance, Sahara Bank has been partly (20%) sold to BNP Paribas which is considered as a European leader in global banking and financial services.

Moreover, Libya recently introduced a series of economic reforms including privatising some state-owned companies, establishing new private companies[9] and reforming the banking sector (Salama and Flanagan, 2005; Twati and Gammack, 2006; Alkizza, 2006; and Ellabbar, 2007). The reform includes the establishment of a new stock market (GPC, Decree 134, 2006) and encouraging foreign investment (GPCO, Law No. 5, 1997 amended by Law No. 7, 2003). It also includes a new banking regulatory requirement (CBL, 1/2005) which requires the Central Bank of Libya to comply with the International Accounting Standards and the International Standards on Auditing.

However, apart from the oil sector, Libya's bureaucracy is one of the most worrying issues for investors. Its legal and policy frameworks are difficult to navigate. The issue of licences and permits are often delayed for significant periods for unspecified reasons. Besides, accurate, current information on the Libyan market and key commercial regulations is difficult to obtain. Thus, this situation serves as a restriction to foreign investment. Furthermore, there are no non-governmental organisations present in Libya to help facilitate regulatory transparency (U.S. Department of Commerce, 2007). Moreover, Tahari et al. (2007) add that Libya's market lacks a modern bankruptcy framework.

Table 2.1: Domestic Production of Petroleum Products, 2002-2007 (in thousands of metric tons)

	2002	2003	2004	2005	2006	2007
Natural gas (bottled)	119	195	191	166.7	196.33	198.8
Gasoline	716	858	654	800	757.9	812.6
Jet fuel	1,487	1,562	1,406	1495.2	1396.2	1470.4
Naphtha (raw)	2,348	2,585	2,474	2769.8	2725.3	2676.5
Gas oil	3,352	3,771	3,842	4103.6	4103.7	4137.1
Fuel oil	5,887	6,244	6,431	7083.8	7053.1	7004.3
Total	13,909	15,215	14,998	16419.1	16,233	16,300

Source: National Oil Corporation cited in IMF (2008a).

The Libyan economy continues to be heavily dominated by the public sector and centrally planned decision-making. Official statements on large-scale privatisation are unlikely to attract broad interest from foreign investors since significant obstacles remain. Although foreign investors are permitted to own a maximum of 65 per cent

[9] GPC Law No 21 (2001) for establishing economic activities & its guidelines Decree No 171 GPC (2006).

of shareholdings in Libyan companies GPC (171/2006), Libya's tightly regulated banking system and restrictions on currency conversion are some of the immediate disincentives facing foreign investors (World of Information Business Intelligence Report of Libya, 2004).

Table 2.2: Production and Exports of Crude Oil and Refined Products 2002-07 (in millions of barrels)

	Production			Exports		
	Daily Average	Total	Change in total in percent	Daily Average	Total	Change in total in percent
2002	1.297	474	-8.4	0.941	344	-10.6
2003	1.534	560	18.3	1.184	432	25.8
2004	1.615	591	5.6	1.256	460	6.4
2005	1.693	618	4.5	1.336	488	6.0
2006	1.761	643	4.0	1.423	519	6.5
2007	1.830	668	3.9	1.471	537	3.4

Source: National Oil Corporation cited in IMF (2008a)

Table 2.3: Libya Government Administrative Expenditure, 2002-07 (in millions of Libyan dinars)

	2002	2003	2004	2005	2006	2007
Expenditure of central secretariats						
General people congress	43	44	47	121	143	116
General people committee	222	204	190	305	209	576
Justice and public security	219	244	284	446	473	856
Education and scientific research [10]	175	196	0	346	405	2143
Finance	42	159	227	407	332	194
Information & culture	0	0	0	0	0	0
Foreign affairs	178	313	393	397	451	720
Planning, economy, and trade	1	1	5	11	8	45
Tourism	0	0	4	2	3	27
Miscellaneous and contingencies	129	87	104	1113	1805	5736
Transfers to public institutions	67	58	72	0	0	0
Public debt	60	132	132	0	0	0
Investment expenditure	100	0	0	0	0	0
Subsidies	499	480	832	1050	1009	1006
Allocations to the regions	2042	2140	2687	3003	3000	0
Others	501	297	336	0	0	0
Total administrative expenditures	4278	4355	5313	7201	7838	11419
Allocations to regions (% of total)	48	49	51	42	38	0

Source: Secretariat of Finance cited in IMF (2008a).

[10] Expenditure for 2004 & 2005 are recorded in allocations to the regions

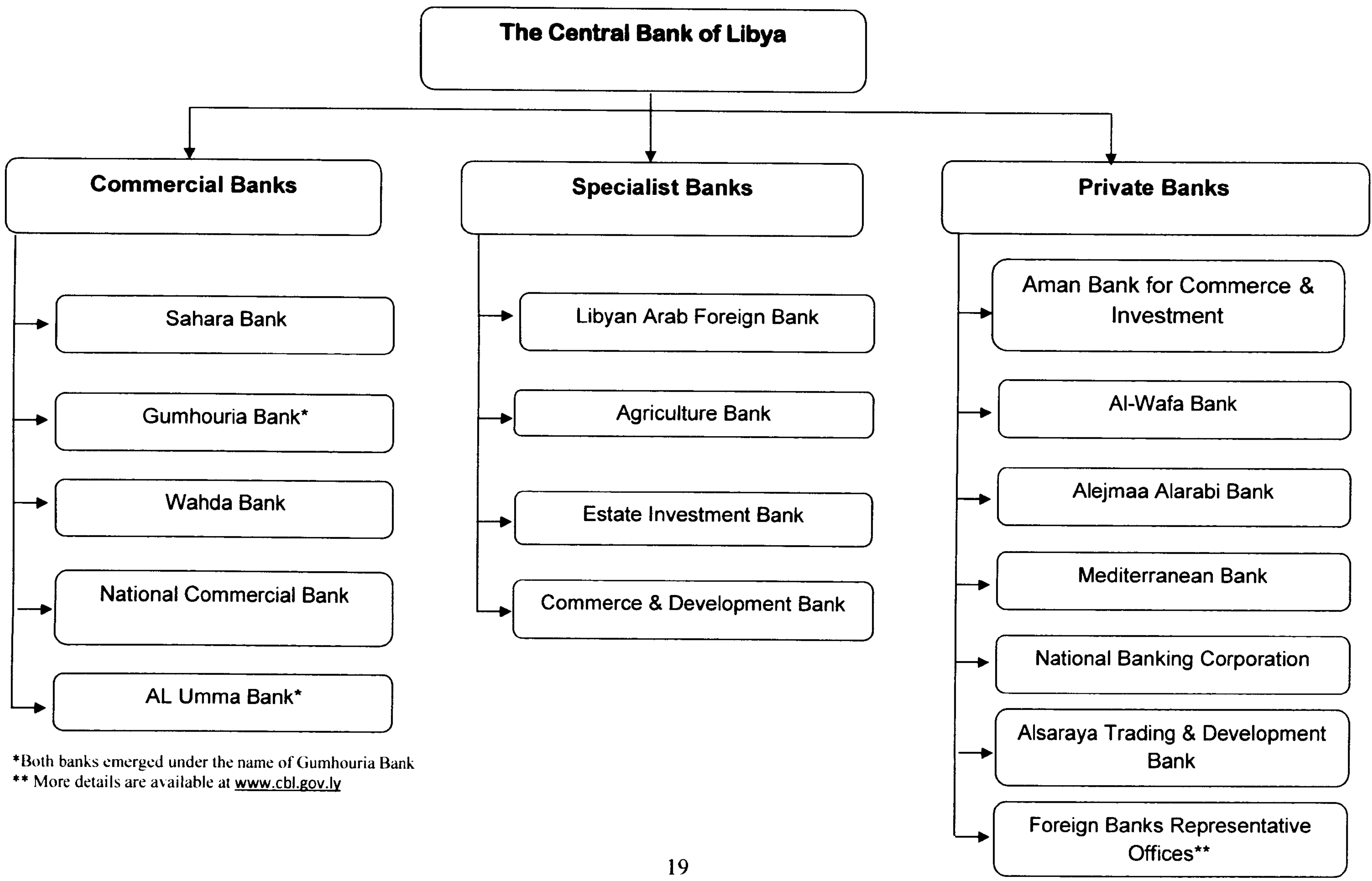
2.5 The Libyan Financial Sector

The Libyan financial sector is dominated by the following parties. They are firstly, five state-owned commercial banks (Mukhtar et al., 2008) [see figure 2.4]. The majority of these banks are owned by the Central Bank of Libya (CBL). Secondly, there are also six private banks, three of which have entered the market since 2001. The private banks are owned by the citizenry and capitalised through mandatory deductions from salaries. Thirdly, four state-owned specialised banks, one of which was partially divested. Fourthly, the nonbank financial sector is small and comprises one offshore investment company and two state-owned nonbank finance companies. In addition, the insurance industry is not mature. Fifthly, there is little insurance activity and there is no equity market (Tahari et al., 2007).

In terms of effective banking supervision, the main remaining challenge is the lack of central bank autonomy. This lack of autonomy can be attributed to the absence of clearly defined legal grounds for the dismissal of central bank governors and board members (Tahari et al., 2007). With regard to the legal inefficiencies which continue to impose major costs on financial intermediation, Libya lacks a modern bankruptcy framework. For example, court proceedings remain lengthy, magistrates and attorneys often lack training in commerce and finance and decisions are costly to enforce, (Tahari et al., 2007). Nevertheless, the commercial banks in Libya play a vital role in providing monetary supply, commensurate with the national objectives of stable prices and sound economic growth. The volume of lending is almost concentrated in the main big cities, which are Tripoli, Benghazi and Sabha, whereas the rural areas have a lower level of lending (Ehtawish, 2006). In addition, the commercial banks are the nation's principal financial institutions which hold more than 95 per cent of the Libyan banking deposits market (CBL 2005 cited in Ehtawish, 2006).

The General People Committee (GPC), the highest executive body in Libya has issued a decree number 134/2006 to establish a stock exchange market in the country. The newly established financial organisation is expected to boost the Libyan economy in general and may increase the demand on external independent audit services. However, Porter and Yergin (2006) argue that the overall quality of financial markets in Libya is poor, where equity markets do not exist and debt markets are still immature.

Figure: 2.4 The Libyan Banking Sector



*Both banks emerged under the name of Gumhouria Bank
** More details are available at www.cbl.gov.ly

The Libyan Business Executive Survey (LBES) and Global Competitiveness Report (GCR) surveys indicate that Libya ranks last among the survey countries on financial market sophistication and 105th among the 111 countries on local equity market access. Along with the low ranking of the Libyan financial market, reporting in Libya suffers from weaknesses, especially for capital expenditures and for decentralised spending in the state-owned sector (Porter and Yergin, 2006).

Within the state-owned sector, the reporting is based on a monthly centralised collection of information about payments made both at central and local levels. For local levels, information comes from the 22 regional committees (Shabiah). It is uncertain whether or not the payments reported are reconciled with the payment orders (issued by the budget controller) and with the banking statements of payment. Commitments are not reported. From the self evaluation of the Ministry of Finance, the quality of this reporting in terms of accuracy and timeliness is low, particularly in relation to capital expenditures. These are reported on a half-yearly basis instead of monthly for current expenditures (The World Bank, 2006).

It has been argued by Khadaroo and Shaikh (2007) that investors' confidence, transparency and accountability are key principles which are perceived as legitimate practises across the globe and are the necessary ingredients for growth and sustainable economic development. However, the Libyan regulatory accounting system lacks a proper transparent model that may help achieve sound corporate governance. Similarly, Velayutham and Perera (2004) and Alqadhafi (2008) argue that transparency and full disclosure are described as crucial and essential prerequisites for achieving accountability. In this regard, the U.S. Department of Commerce (2007) reports that the Transparency International positioned Libya 105th out of 163 countries which indicates least corrupt in its 2006 Corruption Perceptions Index. Moreover, one could attribute the insufficient performance of the Libyan financial sector to the absence of domestic financial reporting standards including local accounting and auditing standards. Therefore, it is worth discussing the Libyan accounting profession development in the following subsections.

2.6 Accounting Profession in Libya

The development of the accounting profession in Libya can be classified into three eras. They are namely: (1) the accounting profession before the discovery of oil in

Libya, while the country was under the Italian occupation; (2) the accounting profession after the discovery of oil in late 1959 when UK and US firms invested in the oil industry; and (3) the accounting profession from 1969 to the present day. The following subsections shed light on these eras.

Firstly, the accounting profession before 1959 (the pre-oil discovery era); during this era, Libya was one of the poorest countries in the world. The population was mainly engaged in agriculture and animal husbandry. Italian expatriates, during the Italian occupation, controlled the few relatively large enterprises in the country. Italian colonialism in Libya did not establish domestic financial or commercial firms (Ellabbar, 2007). However, Italian companies brought with them Italian accountants and introduced the income tax law in 1923. This point in time is considered as the starting point of accounting practise in Libya (Kilani, 1988). Moreover, during this era, Khorwatt (2006) reports that financial accounting was the only branch of accounting which existed. There was no evidence of any management accounting or any major development of accounting and auditing in Libya until the oil discovery era.

Secondly, the accounting profession from 1959 to1968 (the post-oil discovery era); during this period, oil was discovered in Libya in 1959 by Standard Oil of New Jersey which was known as Exxon at the time. Libya started exporting its first crude by 1961; ten years later, it ranked among the world's top 10 oil producers (Mouawad, 2005). In this vein, Ahmed and Gao (2004) argue that the Libyan accounting profession has been influenced by British and American accounting standards and practises. Moreover, the accounting profession in Libya is still under the influence of the UK and USA inherited standards. Such influence has come through the American and British companies which were managing oil and non-oil firms operating in Libya during the colonial period and through their advisors to Libyan firms and governmental organisations after Libya's independence. Therefore, the accounting profession in Libya is oriented toward the accounting environment and the private sector of the UK and USA.

It can be concluded that the accounting practice in Libya is US and UK oriented. In this regard, Bait-El-mal, et al., (1973) state that accounting principles and auditing standards in Libya follow the GAAP of Britain. This is as a result of British rule after

the Second World War. Large firms and government advisors were British; the director of the State Accounting Office, J. H. Newbegging was a British chartered accountant. The State Accounting Office published in November 1963. It was an independent agency reporting directly to the prime minister, that is, until the First of September Revolution in 1969.

Thirdly, the accounting profession from 1969 to the present day (the revolutionary era): on 1st September 1969, Colonel Mua'mar Al-Gathafi took power and overthrew the monarchy system. During this era, which is the focus of this research, and due to the growing number of accounting firms and lack of regularity in accounting and auditing standards and practices in Libya, the government enacted law No. 116[11] of 1973 to establish the Libyan Accountants and Auditors Association (LAAA hereafter) to develop the accounting profession in the country. However, the absence of the form and content of financial statements in Libya has resulted in the emergence of different forms of financial statements, even ones within the same industry (Ahmad and Gao, 2004). Thus, this resultant problem highlights the limits and weaknesses of the regulatory role of the LAAA in developing the accounting profession.

The accounting development in Libya is still faced with some constraints. It has been argued by Mahmud and Russell (2003) that there are some factors identified as barriers to the development of accounting education and practise. These obstacles being: a lack of active professional societies; inadequate public understanding of the role of accounting; outmoded accounting curricula and a lack of modern textbooks. However, the status of the accounting profession and the availability of accounting educators are not perceived to be obstructing factors in developing the accounting profession. The accounting practise in Libya has also been influenced by legal impact from three major regulating laws. These laws are: the Libyan Commercial Code (LCC); the Income Tax Law and the Petroleum Law. The Libyan Commercial Code (LCC), which has existed since 1953, requires that all business enterprises operating in Libya be registered on the commercial registrar with the Minister of Economy. Accounting education in Libya also has been influenced by British orientation. Textbooks and accounting curricula in the faculty of economics and commerce at the University of Libya were British (Bait-El-mal et al., 1973).

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[11] For more details about this act see appendix 1.

During this era, the Libyan government established a government-affiliated Institute of Public Control (IPC) which oversees state-owned business and companies. The IPC also provides audit services to state-owned companies. However, IPC members (auditors) who work for the Institute of Public Control and the Institute of Financial Auditing (IFA) are affiliated to the government; this leads to a lack of independence. In addition, a lack of motivation and incentives for auditors to maintain independence has resulted from the absence of clearly defined auditor liability as well as the absence of commercial court and a modern bankruptcy framework in Libya (U.S. Department of Commerce, 2007 and Tahari et al., 2007).

However, due to its lack of personnel, the IPC was incapable of providing audit services on time, and the delay in the auditing of accounts has become an inevitable and serious problem. Accordingly, public accountants (private accounting firms) have been authorised to provide audit services to state companies, with the result that the demand for qualified public accountants has increased (Ahmed and Gao, 2004). Although the Libyan government established the Libyan Accountants and Auditors Association which was founded by Law 116/1973 for the purpose of developing the accounting profession, it has played no role since its establishment. It was only in 2006 that the LAAA passed a draft including interpreted International Accounting Standards with the minor amendment which may suit the Libyan environment (The Accountants Magazine, 2007). Otherwise, the accounting profession in Libya still follows the UK and USA accounting principles.

2.7 Accounting Standards in Libya

Accounting principles and auditing standards in Libya follow the GAAP of Britain. This is as a result of British rule after the Second World War. In addition, the Central Bank of Libya recently enacted Banking Law 1 (2005) to comply with the International Accounting Standards (IASs). This law also permits foreign banks to operate in the country (CBL, 2005). In addition, companies are also required to comply with the International Accounting and Auditing Standards (GPC, 134 /2006). In terms of the audit profession, Ritchie and Khorwatt (2007) state that the auditing profession in Libya is subject to three distinctive influences. They are namely: laws and legal requirements; socio-cultural imperatives of family, tribe and community; and quasi-legal professional requirements of the LAAA.

Although Libya has inherited the accounting practice and procedures of British and American Principles, there is no explicit formal set of Libyan Accounting Standards about the form and content of the fiscal financial statements (Bait-El-Mal et al., 1973; Kilani, 1988; Mahmud and Russell, 2003; Ahmed and Gao, 2004; and Ritchie and Khorwatt, 2007). In this regard, Wallace and Wilkinson (2004) point out that there are no Libyan accounting and auditing standards and there is no standard setting body. Epstein and Mirza (2004) point out that several developing countries do not have their own national accounting and auditing standards, instead they follow either the US GAAP, or the International Financial Reporting Standards (IFRS). In addition, Deloitte (2009, p: 1) states that "*most entities* [in Libya] *apply International Financial Reporting Standards (IFRS)*".

The accounting profession in Libya is still practiced in accordance with a variety of acts and laws and it is still open to whoever wants to practice it. This is because LAAA membership is very easy to obtain and it does not require any effort, for example, to pass any particular exam. In this vein, Derwish et al. (2004) argue that auditing services in Libya face three different challenges. Firstly: re-organising the audit profession because it has not been regulated so that it meets the national needs of users and foreign investors[12]. In addition, the IPC and IFA are both considered the dominant bodies in overseeing and ensuring corporate governance in most state-owned entities. Secondly, the entrance of the Big 4 auditors to the country seems to have created a competitive audit market in which local audit offices find it difficult to survive. Thirdly, meeting the requirements of the WTO in terms of trading services (the audit service is no exception) entails a standardised level of skills and accepted professional qualifications.

In terms of qualifications, the Libyan government accredited a university degree as an adequate qualification for professional recognition without requiring further examination, subject only to acquiring practical experience. In the 1970s, with the increase of accounting graduates from the University of Libya and the return of many Libyan graduates from abroad, many Libyan-run accounting firms were established (Ahmed and Gao, 2004). The total number of Certified Public Accountants (registered accountants with the Libyan Accountants & Auditors Association LAAA)

[12] For more details about the foreign companies investing in Libya refer to appendix 11.

in Libya is shown in appendix 2. It can be seen from Appendix 2 that the total number of Certified Accountants in Libya is 1496 members (LAAA, 2008).

Accountants who are granted a license to conduct the profession must meet the following conditions: (1) hold Libyan nationality; (2) have a bachelor's degree in accounting; (3) have five years experience of accountancy-related jobs in an accounting office after graduating with a bachelor's degree; (4) be active over political and civil rights; and 5) be of good conduct, reputation and respectability, commensurate with the profession (Ahmed and Gao, 2004). However, LAAA requirements do not include any training or passing any exams related to the accounting profession. Therefore, one could argue that omission of standard measures and exam requirements seem to leave the accountancy profession far behind and place a heavy burden on the LAAA shoulders to regulate the accounting profession.

The accounting profession in Libya entails an independent auditor. The auditor's independence regulatory requirements prohibit auditors from combining their status as a chartered accountant with certain activities such as: (1) a ministerial position; (2) any public post, permanent or temporary, with salary or compensation (unless auditors are permitted to do so according to the provision of this law); (3) any commercial activities; and (4) all other activities which are not compatible with the profession (Law No.116 article, 25). Furthermore, Law No.116, article 49 states that it is illegal for the members of the LAAA to advertise or to use mediators in order to practise the accounting profession, and all the members of the LAAA are required to meet all obligations that may be imposed on them by the law and by the ethics of the profession. However, Law 116 does not prohibit providing any non-audit services[13]. This kind of service is perceived to be a source of threat[14] to the perceptions of third party users towards auditor independence. Moreover, Law 116 neglects the rotation[15] (audit tenure) with which auditors and / or audit partners comply, therefore, non-rotation could lead to a familiarity threat (Fearnly et al., 2005).

[13] For more details about the services see section 3.7 page 54.
[14] These threats, according to the UK, EC & IFAC Auditor Independence Frameworks, are highlighted in chapter 3 page 36.
[15] For more detail about this regulatory requirement see section 3.10 page 71.

Law 116 of the LAAA also requires auditors to comply with the ethics and codes of their profession. However, Porter and Yergin (2006) point out that there are no explicit guidelines or written local standards nor are there codes which auditors comply with. As the profession in Libya had not yet established such a code of ethics, a suggested code of ethics was proposed to the LAAA by one of the academic accountants. This code was taken entirely from the AICPA's code of ethics, and comprises the same rules of conduct as in the USA. It contains the following rules: (1) independence; (2) integrity and objectivity; (3) general standards; (4) conformity with accounting principles; and (5) auditing standards. In addition, Mohamed (2004) proposes an auditor independence framework[16] for Libyan auditors.

Recently, the Libyan government divided the IPC into two institutions. They are the Institute of Inspection and Public Control and the Institute of Financial Auditing (IFA, Law 3 2007). The principal objective of the IFA is to regulate and audit all state-owned organisations. However, in terms of branches of foreign oil companies, they are subject to audit by the National Oil Corporation of Libya (NOC). Moreover, foreign companies registered under Law No.5 of 1997 (Encouragement of Foreign Capital Investment) are subject to audit by the Investment Encouragement Authority (Wallace and Wilkinson, 2004). Moreover, Ernst and Whinney (2002) report that foreign companies operating in Libya are required by law to maintain a detailed general ledger, general journal and inventory ledger. These books should enclose every transaction entered into by the company. Before use, the statutory books must be stamped as registered with the tax and legal authorities. In addition, all foreign companies are subject to audit by the Institute of Financial Auditing (IFA). However, in practice they are audited by the tax and social security departments.

Most countries which have a mature accounting profession have adopted a specific form for the audit report to be used by all members of the organisation. However, the LAAA has not specified a standard form for the auditor's report. However, previous studies have been conducted in Libya concluded that the Libyan auditor uses the form of both the American and British audit report (Bait El-Mal et al., 1973 and Kilani, 1988). In this regard, Khorwatt (2006) reports an example of using the form of the

[16] For more details see appendix 3.

American audit report[17] which is provided by a Libyan auditor for one of the Libyan companies.

On the other hand, and as a result of the slight increase in demand, audit services are more likely to develop to the level of independent external assurance and audit services as a result of increasing foreign oil investors. However, due to a lack of personnel who may supply accounting and audit services, the Big 4 audit firms[18] entered the country recently. However, the law 116/1973 prohibits foreign chartered accountants (non-Libyans) from providing an external audit. Consequently KPMG, Deloitte, Ernst & Young and PricewaterhouseCoopers have been involved in partnerships with local Libyan auditors in Tripoli. The Big 4 auditors then manipulate the loopholes in this law and thus they provide accounting and audit services in the Libyan audit market.

2.8 Summary

This chapter aims to provide an essential part of the background to the study by presenting demographic information about Libya including its population and location. It also provides a brief background about the Libyan economic environment where auditors and users of audited financial statements operate. This chapter also highlights the cultural background about the Libyan community. In this chapter the researcher aimed to shed light and provide insights into the nature and characteristics of accounting and auditing professions in a developing country such as Libya where this study investigates the perceived auditor independence and the perceived reliability of audited financial statements. The relevant auditor independence literature is discussed in the next chapter.

[17] Refer to appendix 4.
[18] Refer to Appendix 5

Chapter 3

Review of Literature

3.1 Introduction

Chapter 2 discussed the development of the accounting profession in Libya. It also provided a background about the economy and the cultural context of Libya where the empirical study takes place. In this chapter, the literature concerning perceived auditor independence and the perceived reliability of audited financial statements is reviewed. This chapter is organised as follows. The second section sheds light on the agency theory which is underlining this study, followed by an outline of the nature of auditor independence. The fourth section reviews the relevant empirical research concerning the potential factors which influence the perceived independent audit of companies' financial statements. It also generates the research hypotheses.

3.2 Agency Theory

An agency relationship arises when one or more principals engage another person as their agent to perform a service on their behalf. Performing this service leads to the delegation of some decision-making authority to the agent (Jensen and Meckling, 1976). In addition, this delegation of accountability by the principal results in the need to place trust in an agent to act in the principal's best interest (ICAEW, 2005). However, concerns arise about the trust due to the differing motives of agents and the conflict of interests between agents and principals. Thus, there are combinations of means that may be used to align the interests of agents (trustees) with principals and to permit principals to measure and control the behaviour of their agents and reinforce trust in agents (ICAEW, 2005). These monitoring mechanisms represent remuneration packages and incentives for agents and external independent audits.

The appointment of external auditors however, may create an additional agency relationship, which in turn impacts on trust and creates new issues relating to their independence. In this vein, Beattie et al. (2000, p: 178) state that '*the traditional agency model of audit is an inadequate characterisation of the activities of external auditors in relation to the audit of client's financial statements. When providing Non-audit services, the auditor is found to be a source of support and advice concerning these audited financial statements*'. Moreover, Beattie et al. (2004, p: 3) point out that '*companies' audited financial statements emerge from the interactions that take*

place between managers and auditors. These interactions can involve conflict which may lead to negotiation and bargaining'. Thus, one could argue that bargaining may result in independence being compromised and that these audited financial statements may be perceived as less reliable.

Therefore, there is an ongoing need to put in place mechanisms (audit committee) to monitor the behaviour (independence) of the auditors (ICAEW, 2005). Within this context of agency relationship, an independent auditor may play a key role in monitoring the agents. In this respect, Bazerman et al. (1997, p: 90) point out that '*Auditors provide information to shareholders and to other stakeholders that is vital to firms' public ownership.* [However,] *an auditor's failure to detect significant misrepresentations in a company's financial statements can lead not only to losses by individual investors, but also to an overall decline of trust in capitalist institutions*'. The real example of auditors' failure is the Enron story in which Arthur Andersen (the Enron auditors worked with Enron's management at the expense of its shareholders [principal]). Similarly, Culpan and Trussel (2005, p: 75) argue that "*a combination of accounting, financial, and managerial misconduct and unethical behaviors at Enron contributed to the company's bankruptcy and the losses by many stakeholders. The transparency in dissemination of information is crucial to the moral defense of stakeholders' interests.* [However] *the Enron management failed to do so. To prevent such unethical conducts, there is a need for new regulations, but firms must also develop and enforce a code of ethics.*"

The rationale behind the need for external auditing is that an independent auditor is expected to monitor and verify financial statements which are prepared by managers (agents) on behalf of owners or shareholders (principals). Within the context of the agency theory, principals delegate resources to agents who are expected to maximise the wealth of the principal against remunerations and bonuses which are paid to these agents. Agents, however, due to inherent opportunistic behaviour, may maximise their own wealth. Therefore, such an agency relationship represents a conflict of interests. This agency relationship highlights the asymmetry of information between principal and agents. Therefore the agency theory intends to mitigate the agency problem and align the gap (asymmetry information) between the principals and agents

by using monitoring mechanisms such as independent auditors (Jensen and Meckling, 1976).

However, the agency theory does not state how auditors are appointed nor does it offer guidance on what an expert is and how claims of expertise are enacted (Sikka, 2009). Moreover, it has been argued by Moizer (1991) that rational economic individuals (auditors are no exception) act in such a way as to maximise their own wealth. Therefore, and based on the economic incentives, one could argue that auditors and managers would collaborate and maximise their own wealth at the expense of the owners or shareholders. Thus, an agency problem (asymmetry information or an audit expectation gap) still exists. This expectation gap is defined by Dixon et al. (2006) as the difference between what auditors provide and what users and the public expect from auditors. However, there are two counterbalancing motives that would result in minimising and mitigating the agency problem. These motives are introduced by DeAngelo's economic model.

This model highlights the economic relationship between auditors and their clients (DeAngelo, 1981a). According to this model, the economic factors include the client-specific quasi-rents that incumbent auditors earn, when they possess a comparative advantage over competitors. The transaction costs involved in changing auditors create advantages to incumbent auditors who can capture future benefits from technological and transaction cost advantages by setting future audit fees above the avoidable cost of performing audits. Incumbent auditor and client economic relationships may create opportunistic behaviour that forms a conflict of interests which may compromise independence. Nevertheless, the existence of similar client-specific quasi-rents from other clients encourages incumbent auditors not to behave opportunistically and instead to maintain their independence (DeAngelo, 1981b) due to fear of losing audit income as a result of reputation loss. Similarly it has been argued by Watts and Zimmerman (1983) that due to the existence of institutional incentives, such as litigation costs and reputation loss, auditors tend to maintain an independent audit.

3.3 Nature of Auditor Independence

According to Beattie and Fearnley (2002, p: 4) there is no formal theory of auditor independence as such and the analytical models regarding auditor independence are

scarce, and the bulk of research has concentrated on determining the factors that may impact on the independent audit of companies' financial statements. Therefore, it can be argued that the unaudited financial statements, presented to company shareholders for use in making decisions, lacks sufficient credibility. This is because of the perceptible lack of objectivity of company managers whose task is to prepare these financial statements and to be responsible for reporting on their own stewardship (Lee, 1972). Therefore, in order to overcome the perceived lack of credibility and to enhance the reliability of the financial statements, which are prepared by company managers, the financial statements should be examined by an auditor who is independent of the preparers (management). Moreover, it has been argued by Lee (1972, p: 67) that '*the remoteness gap*[19] *which exists between company shareholders and management has resulted in an increasing need for an independent auditor who is expected to act as a bridging device that makes management accountable to the shareholders via the required annual financial statements which are verified by the independent auditors*'.

An audit, by an independent external auditor, enhances the reliability of the financial statements by providing reasonable assurance that they present a true and fair view (Mautz and Sharaf, 1961). Moreover, Higson and Blake (1993, p.104) state that '*auditors have been required to report explicitly on whether the financial statements do give "a true and fair view"*'. Therefore, the more independent the auditor is, the more reliable the financial statements are as perceived by shareholders and other users. Similarly, Moizer (1991) argues that users of financial statements for decision making, need to be reassured that accounting information contained in the financial statements is reliable. The reliability of financial statements is fundamental for companies. This is due to the fact that investors' confidence is based on these statements. Furthermore, an audit's monitoring mechanism enhances the credibility and the reliability of financial statements (Nelson et al., 2008). Yet the reliability of audited financial statements is dependent, in part, on the auditor's independence. The reliability of audited financial statements (RAFS hereafter) is central ground on which users of these

[19] The larger the company, the more the two groups are likely to become physically and mentally remote from one another. Shareholders tend to become less conversant with the day-to-day affairs of their company as it grows and find themselves physically and mentally removed from their company's activities which are delegated to agents who run it on their behalf (Lee, 1972).

statements make rational financial decisions. These decisions, whether investment or lending, are therefore influenced by the reliability of these audited financial statements (Stettler, 1970). Similarly, true and fair view rules require that the accounting information contained in the financial statements is reliable if they satisfy the reasonable expectations of users.

Moreover, these expectations are determined by generally accepted accounting practice (GAAP) and this implies that accounting and auditing standards will be observed (Glautier and Underdown, 1986). It can, therefore, be argued that audited financial statements are perceived to be more reliable if audited by an independent auditor. An independent auditor may therefore play a key role in monitoring the agency relationships between principals (e.g. shareholders, investors and creditors) and agents (managers) (Watts and Zimmerman, 1986). In addition, Moizer (1991) states that there are two counterbalancing economic reasons which motivate auditors to act in an independent manner. These reasons are: litigation costs as a result of negligence and drop in fee income as a result of reputation loss among users who seek audit services. Furthermore, Firth (1980) argues that auditors' independence is traditionally considered as being one of the primary principles underlying the auditor's task. However, lacking independence, the auditor's work would be considered a waste of time and effort which adds no verification or assurance to the users of financial statements which were previously prepared by management. Thus, it can be argued that the auditor independence has increasingly become a significant issue, especially after the collapse of Enron in 2001 which has led to regulatory audit reform by professional bodies.

The professional bodies focus more on the reform of auditor independence regulations within the developed countries. Audit regulation should be intended to ensure independent verification of financial statements and compliance with accounting principles through professional external auditing, and should also include rules designed to ensure the independence of the auditor as well as a mechanism for enforcing compliance with accounting and auditing standards (IFAC, 2002). For instance in the USA, the US congress passed into law the SOX 2002 Act in order to restore the public confidence in the capital market through safeguarding and

enhancing auditor independence, which may lead to an increased reliability of audited financial statements.

However, the recent financial crisis of 2008 seems to affect the perceived reliability of audited financial statements. For instance, Lehman Brothers received an unqualified audit report from one of the Big 4 audit firms (Ernst and Young). The financial statements of Lehman Brothers mention derivatives contracts with a face value of $738 billion and fair value of $36.8 billion. Although the financial crisis is getting worse, Lehman's auditors did not express any suspicions about the value of the derivatives or any situation under which the company may be unable to meet its obligations. Just two months later, Lehman collapsed (Sikka, 2008). One may conclude that investors could lose confidence in the reliability and credibility of such financial statements given the extent of these possible misstatements that may result from a lack of auditor independence.

Independence in auditing is defined by Arens and Loebbeck (1999) as taking a neutral viewpoint in the performance of audit tests, the evaluations of the results and the issue of an audit report. In this vein, Higson (2003, p: 115) states that "*if an auditor is not independent, one would presume that the audit is a waste of time and that the figures in the financial statements may be meaningless*". Most countries do not allow professional accountants to be an employee or part of management, but some countries allow the professional accountant to sit on the board of directors and to have a small financial interest. For instance in the USA the GAO (2007, p: 29) requires that

'*In all matters relating to the audit work, the audit organization and the individual auditor, whether government or public, must be free from personal, external, and organizational impairments to independence, and must avoid the appearance of such impairments of independence*...[and that] *auditors and audit organizations must maintain independence so that their opinions, findings, conclusions, judgments, and recommendations will be impartial and viewed as impartial by objective third parties with knowledge of the relevant information. Auditors should avoid situations that could lead objective third parties with knowledge of the relevant information to conclude that the auditors are not able to maintain independence and thus are not*

capable of exercising objective and impartial judgment on all issues associated with conducting the audit and reporting on the work'.

Independence implies integrity, honesty and complete objectivity. According to the codes of ethics for professional accountants the IFAC (2007, p: 22) highlights the integrity in three provisions, as follows:

(1) *the principle of integrity imposes an obligation on all professional accountants to be straightforward and honest in professional and business relationships. Integrity also implies fair dealing and truthfulness*; (2) *a professional accountant should not be associated with reports, returns, communications or other information where they believe that the information*: (a) *contains a materially false or misleading statement*; (b) *contains statements or information furnished recklessly*; *or* (c) *omits or obscures information required to be included where such omission or obscurity would be misleading*; (3) *a professional accountant will not be considered to be in breach of provision number 2 if the professional accountant provides a modified report in respect of a matter contained in provision number 2.*

The IFAC (2007, p: 23) codes of ethics for professional accountants regarding objectivity is addressed in two provisions. They are: (1) *the principle of objectivity imposes an obligation on all professional accountants not to compromise their professional or business judgment because of bias, conflict of interest or the undue influence of others*; and (2) *a professional accountant may be exposed to situations that may impair independence. It is impracticable to define and prescribe all such situations. Therefore, relationships that bias or unjustifiably influence the professional judgment of the professional accountant should be avoided.* In addition, the American Institute of Certified Public Accountants (AICPA, 1991, p: 50) emphasizes that:

'To maintain independence, auditors must be intellectually honest....While independence in appearance relates to the avoidance of facts and circumstances that are so significant that a reasonable and informed third party, having knowledge of all relevant information, including safeguards applied, would reasonably conclude a firm's, or a member of the assurance team's, integrity, objectivity, or professional scepticism had been compromised.'

The perceived auditor independence is an important element by which the reliability of financial statements can be assessed. In this regard, it has been argued by Cosserat and Rodda (2009) that auditor independence is the essence which underlies the success and credibility of the accounting profession and its services to the public. Auditor independence also helps to provide the objectivity that facilitates the audit profession to perform its verification and monitoring roles effectively. Similarly, Lee (1972) points out that users' confidence in the accounting information is closely related to the position of independence which the auditors adopt. However, the essential objective of independent audit is not independence for its own sake; it is rather to ensure the ongoing reliability and relevance of accounting information and financial reporting and effectiveness of the system of capital formation (Wallman, 1996).

Auditor independence can be considered in terms of two concepts: actual independence and independence in appearance. The former refers to an unbiased mental attitude of the auditor, while the latter refers to the perceptions of third parties who observe that the auditor is free from the influence (relationships) of the audit client (AICPA, 1993). Furthermore, the IFAC (2007) requires both independence of mind (actual) and independence in appearance. In this vein, according to Mautz and Sharaf (1961), auditor independence comprises two sides, namely practitioner independence and professional independence. The former refers to the individual auditor and consists of three elements. The three elements are (1) programming independence which entails auditors to be free from any managerial pressure in performing their audit programme; (2) investigative independence that requires and allows auditors to have full access to information they require to perform the audit work; and (3) reporting independence which states that auditors should be able to report freely any discovered breach and express their independent opinion about the audited entity to third parties who may make informed expectations about the audited entity. The latter refers to the professional independence which is concerned with public confidence and the perceptions of the auditor's independence (the image as seen by third party or users and / or and potential users) which is expected to add credibility and reassures users and interested parties that financial statements (which are attested by independent auditors) present a true and fair view about the audited entity.

However, the perceptions of third parties and other users of financial statements are believed to be fragile and can be affected by external threats. These threats, according to the UK, European Commission and IFAC frameworks, are: (1) self-interest threat which occurs when auditors have financial interests in their clients; (2) self-review threat that arises from the challenge that auditors face when verifying their previous non-audit services; (3) advocacy threat which takes place when the auditor becomes an advocate and is seen as a supporter consultant to their clients; (4) familiarity threat which arises from the risk that auditors may become familiar and too trusting of management representations so that auditors inadequately test the management presentations; and (5) intimidation threat that may occur when the auditor may become intimidated by threats such as the dominating personality of a manager or a director Fearnley et al. (2005, p: 46).

From the above outline, it can be argued that self-interest threat, self-review threat, advocacy threat and familiarity threat may occur when auditors provide non-audit services (NAS) along with audit services to their audit clients. Auditors who supply non-audit services to their clients, which form a crucial part in generating audit revenue, appears to represent a self-interest threat. The self-review threat occurs when an auditor examines his or her own work that was previously supplied as a NAS. The advocacy threat arises when auditors provide routine non-audit services and become employees of the audit client, as in the case of Enron where the auditors possess permanent offices and appeared as advocates to Enron rather than independent auditors. Providing non-audit services and long association with the client may create a feeling of familiarity and too trusting of the management presentation so that auditors do not apply enough efforts and become less rigourous in testing the management's presentation. The intimidation threat may occur when auditors are appointed by management which possess an economic power by which managers (agents) exert pressure over these auditors (Fearnley et al., 2005).

The agency relationship between agents and principals would function properly if monitored by outside auditors who may be appointed by a party independent of agents or management. However, due to business complexity, principals or shareholders become isolated from their entities, and thus managers or agents have the upper hand in that they have access to sensitive information about principals' business. Thus,

management hires external auditors to verify accounting information prepared by the management. However, the contractual relationship between auditors and management creates further agency relationship. Therefore, this chapter examines what factors may affect this relationship.

Auditing literature suggests that the credibility of financial statements depends on the perceived independence of the external auditors by the users of the financial statements (Dykxhoorn and Sinning, 1982). Similarly, Firth (1980, p: 451) points out that "*if an auditor is not truly independent then his opinion on a company's financial statements will be of no value*", and that users' confidence of financial statements will also be threatened. This is attributed to the reason that audit reports have significant impact on investment decisions (Firth, 1978). Thus the credibility of auditors depends on both the fact and the perception of independence. However, since the actual independence of an auditor is unobservable, this research will focus on the independence in appearance through reviewing the literature that examines users' perceptions of auditor independence.

Knowledge of perceived independence and factors that may affect it should provide better understanding of the direction of such influences on the auditor independence and consequently on the perceived reliability of audited financial statements. The objective of this study is to investigate these factors that may affect the perceptions of auditor independence. A review of the relevant literature identified the factors outlined below that may influence the perceived auditor independence. Most of these factors have been studied in developed countries and very few have been conducted within developing regions.

Among those factors: (1) the audit firm size (e.g. McKinley et al., 1985 and Awadallah, 2006); (2) the audit fees size (e.g. Hay et al., 2006); (3) the degree of competition in the audit market (e.g. Alleyne et al., 2006); (4) providing non-audit services to the audit client (e.g. Eduardo et al., 2002; Gul et al., 2006, and Davis and Hollie, 2008); (5) legal incentives (e.g. Shafer et al., 1999); (6) the audit committee (e.g. Abbott et al., 2000); (7) the auditors' tenure (e.g. Gates et al., 2007); and (8) culture (e.g. Patel et al., 2002; and Hope et al., 2008). These factors are examined in the following subsections in turn.

3.4 Audit Firm Size

It has been argued by Mautz and Sharaf (1961) that big audit firms are seen to be more independent than small audit firms. This is attributed to the fact that large audit firms are less dependent on one client and the client's audit fees generally represent a smaller portion in relation to the total audit revenue. Similarly DeAngelo (1981b, p: 197), states that *'the larger the auditor as measured by the number of current clients and the smaller the client as a fraction of auditor's total quasi-rents, the less incentives the auditor has to behave opportunistically, and the higher the perceived quality of the audit'.* Moreover McKinley et al., (1985) argue that financial statements audited by the Big 8 auditors (now known as the Big 4) were perceived to be more reliable than those audited by non Big 8. However, after the Enron bankruptcy and the related collapse of Arthur Andersen, the quality of audits being provided by large international Big 4 accounting firms are brought into question (Francis, 2004). Therefore, one could argue that large audit firms (Big 4 audit firms or other large audit firms) are not necessarily more resistant to client pressure and thus their independence may become impaired.

The size of audit firm is acknowledged by Shokley (1981) as a significant factor that may affect perceptions of auditor independence. He investigates the effects of audit firm size, competition, rotation of auditors and non-audit services (NAS) on the perceptions of auditors' independence in the USA. The size of audit firm is categorised into two levels: large and small audit firms. The subjects of the study consist of four groups. These groups are partners from the Big 8 / Big 4 audit firms, partners from local or regional audit firms, commercial loan officers and financial analysts. The participants were provided with sixteen scenarios and required to respond to a scale of one to seven to indicate their perception that independence of an audit firm may be impaired in the light of these four factors. Out of 277 questionnaires, an overall response rate of 64 per cent was obtained. The results indicate that commercial loan officers, partners from Big 8 / Big 4 audit firms, and financial analysts perceive that small audit firms are less independent than are large audit firms. However, audit partners from local or regional audit firms perceive the contrary to the other groups of respondents. The latter perception is attributed to the possibility that 'it reflects a defensive attitude on the part of the small CPAs or a superior attitude among the Big eight CPAs' (p: 794).

Gul (1989) examined the impact of audit firm size, competition, audit committee, the financial condition of the client and non-audit services on the perceived auditor independence from the viewpoint of bank officers in New Zealand. The size of audit firm is classified into large and small. Large audit firms are defined as those firms which possess resources to provide audit services to large corporations listed on the New Zealand Stock Exchange. Small audit firms are defined as those audit firms which do not have such resources. A questionnaire survey was conducted among 64 bankers. Out of 64 research instruments mailed, an overall response rate was 76 per cent. Respondents were provided with eight scenarios on which they were required to respond on a scale of 1 (little to no confidence in auditor independence) to 7 (very high confidence in the auditor's independence). The results indicate that lending officers perceive that the size of audit firms affects the auditor independence. In other words, banking officers have more confidence in audits provided by large audit firms than small audit ones'.

Another study conducted by Gul (1991) in New Zealand, examined the impact of audit firm size, non-audit services, competition and size of audit fees on bankers' perceptions of the auditors' aptitude to withstand management demands in an audit conflict position. The size of audit firm is similarly defined as in his previous study with the same research instrument for data collection. The sample of 72 bankers seems larger than the one in Gul's (1989) study. Participants were given sixteen cases of audit disputes of which they are required to respond on a scale of 1 to 7 to indicate their perceived answer so that management would obtain its preferred resolution to a disagreement between the auditor and the client regarding the materiality of certain unrecorded liabilities. The results indicate that small audit firms are professed to be in a position to resolve the dispute in favour of the client than larger audit firms.

Niemi (2004) examined the impact of the size of the auditor's business on their remuneration and consequently their independence. He investigated whether small audit firms are able to differentiate their audit services, or whether audit clients perceive the audit of small audit firms as a standard product. An overall response rate of 57 per cent, which represents 155 out of 273, responded to a questionnaire survey mailed to 103 small Finnish audit firms. Small audit firms are defined as sole practitioners or very small partnerships. The participants were questioned on pricing

issues and billing units and billing rates. The results indicate that small audit firms with large billing rates (more clients to serve) tend to protect their reputation through the fact that product differentiation takes place among the small Finnish audit firms examined. The results also indicate that both size and technical capability have a constructive effect on auditor remuneration and consequently auditor independence.

Abu Bakar et al. (2005) examined the impact of six variables on the perceived independent audit from the standpoint of loan officers in Malaysia. The variables examined were: the size of the audit firm; the level of competition within the audit market; the tenure of an audit firm; the size of audit fees; non audit services (NAS) and the audit committee. They also investigated how important the audit report is for loan officers in making their lending decisions. In their study, Abu Bakar et al. used a quantitative approach in collecting data by a questionnaire mailed to 240 bankers. An overall response rate of 35.8 per cent was obtained. Respondents were required to circle "yes" or "no" if an audit firm size has any effect on auditor independence. Respondents were also given statements about which they were required to indicate their level of response on a scale of 1 to 7 where 1 means 'strongly agree' and 7 means 'strongly disagree'. The results indicate that there are positive associations between audit firm size and auditor independence. They also conclude that the size of audit firm affects auditor independence. Abu Bakar et al. conclude that auditors of large audit firms appear to be more independent than those of small ones.

A further study by Awadallah (2006) examined the effects of four factors which may influence auditors' capability to oppose client management pressure. These factors were: size of audit firm, provision of non-audit services (NAS), level of competition and client corporate governance structure. To collect data, a questionnaire survey was mailed to 150 professional auditors in Egypt. A response rate of 70 per cent was received. Respondents were given sixteen scenarios and asked to indicate for each scenario on a seven-point Likert scale, from 1 (very low likelihood) to 7 (very high likelihood) about how likely, in their opinion, it is that the unrecorded liabilities will be ignored for the purposes of the financial statements as well as the auditor's report, which is the alternative that the client's management desires. The size of audit firm is depicted into two levels, Large and small. The results indicate that small audit firms are believed to be less independent than large audit firms.

In addition to the above empirical studies, Alleyne et al. (2006) investigated the auditors' and users' perceptions of auditor independence. They examined the affect of twelve variables on the perceived auditor independence. These variables were: audit firm size; economic dependence of the auditor on the audited; high level of competition; provision of non-audit services by auditor; flexibility of accounting standards; audit committee; financial interest in client; large size of client; costs to company of auditor change; regulatory rights and requirements surrounding auditor change; risks to auditor arising from poor quality audit and regulations concerning the appointment of auditors. A questionnaire survey was conducted among 66 auditors and 148 users in Barbados. Respondents were asked to indicate to what extent small audit size affected independence on a scale of 1 to 5, whereby 1 = seriously undermines independence, 2 = slightly undermines independence 3 = no effect on independence, 4 = slightly enhances independence, and 5 = strongly enhances independence. The results indicate that small audit firm size and being a sole practitioner negatively affect perceived auditor independence.

The above studies generated conflicting evidence regarding the impact of audit firm size on the perceived auditor independence. In other words, the majority of the above studies which attempted to investigate the association between audit firm size and the auditor's independence found positive relationships between audit firm size and the independence of auditors. They are for instance, Shokley (1981), Gul (1989), Gul (1991), Abu Bakar et al. (2005), Awadallah (2006), and Alleyne et al. (2006). They argue that large audit firms with more clients are perceived to be more independent than small audit firms. Other evidence (Niemi, 2004), however, suggests the contrary by arguing that small audit firms with large billing rates are likely to protect their reputation by supplying high quality audits. This is believed to be attributed to the market-based institutional incentives which regulate both big and small audit firms. However, small audit firms, within developing countries, that incur high audit fees may face difficulty in resisting their clients' wishes and thus compromising their independence and therefore they may produce misleading financial statements. The subsequent section discusses the effect of audit fees size on the auditor independence.

3.5 Size of Audit Fees

Client firm size is one of the strong characteristics that may influence the firms' demand on independent external audits. Similarly, large firms, comprising owners and / or stockholders, may delegate agents to manage these firms (Chow 1982). However, due to the inherent problem emerging from the differing incentives of diverse stakeholders (e.g. investors, owners, lenders and managers), the classic principal-agent relationship imposes the need to put in place a mechanism that may mitigate the agency problem between principals and agents (Jensen and Meckling 1976). Therefore, one could argue that large clients have higher demands on external auditing. External auditors, on the other hand, are expected to monitor the accounting procedures and financial statements produced by management (agents) and report whether or not management is maximising the wealth of the principal. Further, since auditors are also agents for management, this creates another agency problem. To ease this agency problem, regulatory requirements may play a major role in maintaining external auditors to be and to be seen as independent and to mitigate the magnitude of the agency costs (ICAEW, 2005).

There is broad literature that examines the impact of audit fee size on the perceived auditor's independence. For instance, the study of DeAngelo (1981a) investigated whether or not low balling (setting audit fees lower than total current costs on initial audit engagements) impairs auditor independence. The study developed a model of audit pricing when incumbent auditors posses cost advantages over competitors in future audits of a given client. She demonstrated that low-balling is a competitive response to the expectation of future quasi-rents and does not itself impair auditor independence. She also argued that regulations which attempt to restrain law balling (without altering the client-specific quasi-rent stream) are envisaged to have no effect on auditor independence.

Firth (1980) examined the impact of 29 auditor-client relationships on the perceptions of auditor independence from the perspective of five groups, namely the Big Eight chartered accountants; other firms' chartered accountants; chartered accountants working in industry and commerce; financial analysts and bank loan officers. A questionnaire including 29 auditor-client relationships was sent to a sample of 750 users and preparers. In the experimental task, respondents were asked whether they

perceive each individual auditor-client situation as likely to impair the auditor's independence. For instance, situation 1 states that "an accounting firm receives 15 per cent of its gross fees from one client", and situation 2 states "one office of large national accounting firm receives 20 per cent of its gross fees from one client, a partner from another office of the practice takes the final responsibility for the audit report". Respondents were asked to reply "independent", or "not independent". An overall response rate of 52 per cent was obtained. The results indicate that when an audit firm receives 15 per cent of its gross fees from one client, subjects perceived that auditor independence would be threatened.

Pany and Reckers (1980) examined the effect of client size, purchase discount arrangements and gifts on the perceptions of auditor independence from the view point of a group of 480 stockholders in companies listed either in New York or on the American Stock Exchange. A questionnaire survey was conducted to collect data. In the experimental task respondents were asked to indicate their response on a seven-point Likert scale. Respondents were also asked to evaluate the auditor's ability to resist pressure from a client to subordinate his audit judgements while the client size (small 1 per cent of the audit revenue or large 10 per cent of the total audit revenue). The overall response rate was 26 per cent. The results indicated that gifts and discount arrangements threatened independence while the effect of client size is not significant.

Gul (1991)[20] examined the effects of four variables, including audit fee size on bankers' perceptions of auditors' ability to resist management pressure. A questionnaire survey was used to collect data. The sample consisted of 72 bank lending officers in New Zealand. The experimental task included a seven-point scale of the likelihood that management would obtain its preferred resolution to a conflict between the auditor and the client concerning the materiality of certain unrecorded liabilities, discovered by the auditor. Respondents were required to assume that the client company was an applicant for a loan and the bank requested audited financial statements to support the loan application. The audit fee size was categorised into two levels: significant (large) and insignificant (small). An overall response rate of 67 per cent was received. The results showed that when the client's audit fees are a

[20] See page (39) for more details about his study.

significant proportion of the auditors' total revenue, auditors are perceived to be in a situation where they may not able to oppose management.

Gul and Tsui (1992) examined the effects of three variables on bankers' perceptions of auditor's independence. These variables were: size of audit fees, financial condition of client and audit tendering. A questionnaire survey, similar to the one used by Gul (1991), was conducted. The sample comprised 40 bankers in Hong Kong. The experimental task was also similar to Gul (1991). The audit fee size was categorised into two levels: significant and insignificant. A response rate of 95 per cent was obtained. The results indicated that financial condition of the client and size of audit fees were significantly related to bankers' perceptions of auditors' capability to withstand management pressure in an audit dispute. The results also indicated that when the client's financial condition is good, and when the size of audit fees is significant (large), bankers perceive that the auditors are less likely to withstand the client's pressure in a conflict situation.

Bartlett (1993) investigated the impact of the size of the audit fee, management consulting, contingent fees, joint ventures with audit clients, budget pressure, normal audit, and accounting background a person possesses on the perception of an auditor's independence. A questionnaire technique was used to collect data. The subjects comprised 300 commercial lending officers, and 300 certified public accountants in California. In the experimental task, subjects were asked to indicate how independent they believed an auditor to be in ten different situations, on a scale of 0 to 100, (where 0 = not independent at all and 100 = completely independent). Independence was defined as an unbiased mental attitude in making decisions about audit work and financial reporting. Audit fee size was dichotomised as representing 1 per cent of the total audit firm revenue, and the audit fee represented 40 per cent of work supervised by an audit partner. An overall response rate of 40 per cent was obtained. The results indicated that the 1 per cent rate case rated much higher in perceived independence than the 40 per cent case. This indicates that the size of audit fees affects the perceptions of auditor independence.

Teoh and Lim (1996) examined the impact of five variables on the perceived auditor independence. These variables were: size of audit fees, rotation of audit firm, non-audit services, audit committee and disclosure of non-audit fees in published accounts.

When the size of audit fees did not exceed 15 per cent of the total audit revenue, respondents were asked whether or not this percentage impaired auditor independence. Respondents were also asked to respond to a ten-point Likert scale where 1 = no confidence and 10 = high confidence. The results showed that perceptions of impairment of auditor independence are more pronounced among non public accountants than public accountants. Therefore, confidence in independence is lessened if the audit fee paid by a single client exceeds 15 per cent of the total audit revenue.

Patel and Psaros (2000) examined the effect of the client size, provision of management advisory service, and level of competition on the perception of auditor independence, within a cultural context of four countries. A questionnaire was used to collect data. The sample comprised final year undergraduate accounting students cross four countries - the UK, Australia, India, and Malaysia. The usable responses were from 298 students across the countries. In the research instrument, the percentage of the total audit fees from one client was expressed as either 5 per cent or 25 per cent. Respondents were asked to indicate by circling the appropriate response –on a nine-point Likert scale - as to the likelihood that external auditors' independence may become impaired. The results indicated that there were some significant dissimilarities on perceptions across the four countries. A large audit fee from one client, on the other hand, is believed to increase the threat to an auditor's independence.

Craswell et al. (2002) investigated the threats to auditor independence posed by fee dependence within the audit firm. A mathematical model was used. The sample consisted of publicly reported Australian audit fee data for 1994 and 1996. The experimental task involved deciding whether or not fee dependence within the audit firm's offices jeopardises auditor independence. It also entailed performing the exercise of independent assessment in auditing by the propensity to issue qualified audit reports. They assume that, if fee dependence affects auditors' independent judgment, then auditors are less likely to qualify the accounts. Specifically, they examined whether or not the exercise of auditor independence in the formulation of the audit opinion is affected by the proportion of audit fees that a client contributes to the total fees earned by the auditor. They developed a model to test for differences in

the fees earned from the client as a proportion of total fees for the audit firm between two groups of clients receiving qualified and unqualified audit opinions. They also performed tests by estimating a propensity to the qualified model incorporating the fees earned from the client. The results indicate that the level of auditor fee dependence has no effect on auditor tendency to issue unqualified audit opinions.

DeFond et al. (2002) examined the impact of non-audit (and audit) fees paid to incumbent auditors on the perceived auditors' independence. The sample consisted of all available proxy statements, of financially stressed firms filed with the Securities and Exchange Commission (SEC), between the fiscal year starting on February 05th 2001 and the year ending October 31st 2001. They developed a regression model to investigate whether audit fees influence the tendency of auditors to issue going concern opinions. The results indicate that there is no association between audit fees and the auditor's tendency to issue a going concern opinion. The results also suggest that regulated audit market with legal incentives, such as litigation costs maintain independent audit and counterbalance the economic dependence formed by higher fees.

Rutledge et al. (2003) examined the impact of national cultures on the perceptions of auditor independence across three countries in the Middle East region. They examined whether or not the perceived effects - of client size; provision of management advisory services; unpaid client fees; and employment of a family member by the audit client - on the auditor's independence are similar across these countries. The subject groups of their study included auditors and financial analysts across three Arabic Gulf Countries (AGC). A mail survey (questionnaire) was used to collect data. The sample consisted of 370 auditors and 269 financial analysts from the three countries: Saudi Arabia, Kuwait, and United Arab Emirates. The experimental task included seventeen scenarios which presented possible combinations of the two levels of the four variables on which respondents were asked to indicate their response on a nine-point Likert scale – from one (very low) to nine (very high risk) - as to the level of risk that the auditor independence may become impaired. In the experiment, 10 percent of audit fee size, from one client in relation to total audit revenue, represented the high level and 3 per cent represented the low level. The response rate was 40 per cent and 31 per cent from auditors and financial analysts respectively. The

results indicate that both groups of users perceive that large audit fee size affects the perceptions of auditor independence.

The study of Ahmed and Goyal (2005) investigated the determinants of external audit fees that audit firms charge to publicly-listed companies within what was previously known as the Indian subcontinent, including Bangladesh, India and Pakistan. The study employed an ordinary least squares model. The sample consisted of 566 company annual reports from manufacturing and allied sectors within these three countries for the year 1998. The results indicate that the determinants of audit fees in South Asian countries are similar to those of other developed and industrial countries. In other words, audit fees are statistically related to client size, whether or not the client is a subsidiary of a multinational corporation. The results also show the existence of a premium fee paid to the auditors of Big 4 firms or firms affiliated to the Big 4. The subsidiaries of multinational corporations also pay significantly higher audit fees. Affiliates of the Big 4 international audit firms also charge higher audit fees for perceived higher quality audit services in the South Asian audit market.

Giroux and Jones (2007) examined the audit fee structure of local authorities in England and Wales. The fees were charged by the Big 4 and other private sector auditors. They adopted a regression model for their investigation. The sample included 409 multi-function local authorities. Their results indicated that actual audit fees were usually above the standard fees set by the audit commission. The Big 4 firms received lower fees on average than other private auditors. This indicates that those firms which charge fees above the standards are not meeting one of the regulatory requirements.

It can be argued that the above studies reviewed have produced a combination of three groups each of which represents its perspective and conclusions. One group concluded that audit fee size had no impact on the perceived auditor independence (e.g. Firth, 1980; DeAngelo, 1981a; Pany and Reckers, 1980; Craswell et al., 2002). Further, DeFond et al. (2002) argue that there is no association between audit fees and the auditor's tendency to issue a going concern opinion. They attribute this to the fact that audit market regulatory requirements, such as reputation loss and legal liability costs, preserve auditor independence and offset the economic dependence incurred by

higher fees. Thus one could argue that this may not be achieved within developing and / or unregulated audit markets.

However, another group of studies concluded that a larger proportion of audit fees, from one audit client, in relation to the total audit revenue, is perceived to impair auditor's independence, (e.g. Gul, 1991; Gul and Tsui, 1992; Bartlett, 1993; Teoh and Lim, 1996; Patel and Psaros, 2000; Rutledge et al., 2003; Abu Bakar et al., 2005; and Alleyne et al., 2006). Apart from these two groups, a third view indicated that high audit fees is synonymous with a high audit quality (independent audit), for instance Ahmed and Goyal (2005) state that a premium fee paid to the auditors of the Big 4 audit firms or firms affiliated to the Big 4, and subsidiaries of multinational corporations, also pay significantly higher audit fees for perceived higher quality audit services in the South Asian audit market. It can therefore be argued that emerging audit markets, in developing countries, demand high quality auditing from the Big 4 auditors. Thus one could observe that the Big 4 auditors are the key dominants in such audit market competition. Competition in the audit market is addressed in the following section.

3.6 Competition in the Audit Market

Audit market changes, which are a consequence of politics and deregulation in key areas and privatisation of important industries in many countries, have resulted in more attention and research being conducted as to the effect of the competitive audit market on the perceived independent audit. In this regard, it has been argued (for example Windmoller, 2000) that these changes may have an impact on the audit market in that global businesses require the services of auditors who could offer a global reach to match the company's global coverage. In addition, the market requires a system of well structured corporate governance including independent audits which provide confidence and assurance about the market where investors require reliable financial statements. However, the level of competition is perceived to have an impact on the auditor's capability to withstand management wishes. In this vein, it has been argued (for example Shockley, 1982) that a high level of competition or a tense competitive audit environment may result in auditor independence becoming impaired '*as competition increases, it becomes more likely that [an*

auditor] will be replaced by an auditor more compliant with the client's wishes and knowing this, the [auditor's] power over the client decreases.' (p. 136).

It has been argued that extreme competition would encourage the practice of low-balling which is a widespread exercise in the market for audit services. Low-balling is defined as the practice of 'setting audit fees below total current costs on initial audit engagement' (DeAngelo, 1981a, p: 113). However, there are mixed perspectives in the literature as to whether low-balling increases the threat that auditors' independence may become weakened. In this regard, DeAngelo (1981a) argues that low-balling does not impair independence. This is attributed to the fact that initial fee reductions are sunk costs and thus irrelevant for future actions or decision-making. Low-balling, on the other hand is a response to competitive forces and is the technique auditors employ so that they compete for expected future quasi-rents. This view is shared by Grout et al. (1994) as they state that '[their] *conclusions are quite striking. Some steps designed to increase the independence of auditors are actually likely to reduce auditor independence: banning low-balling (as in Texas) will tend to increase rather than decrease the quasi-rents accruing to incumbent auditors and thereby increase the stake that they have in the continuation of the client company*' (p: 343).

Shockely (1981)[21] examined the effect of four factors including competition on the perceptions of auditors' independence. In the experimental task, competition was depicted as "high" and "low". Each subject was required to make a subjective judgement of the relative strengths of 16 scenarios along a numerical scale from one to seven. The scale represented the risk that an audit firm's independence may be threatened. The results indicate that the subjects considered the impact of competition for audit clients as increasing the risk that an audit firm might lose its independence. In other words, firms operating in highly competitive environments are perceived as having a higher threat of impairment of independence.

Knapp (1985) examined the influence of four variables on the bank lending officers' perceptions of the auditor's aptitude to withstand client pressure. The variables were competition, non-audit services, client's financial condition, and nature of conflict issues between auditors and their clients. Competition within the audit market

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[21] Refer to page (38) for more details about his study.

services was depicted at two levels, "high" and "low". A questionnaire survey was utilised to collect data amongst a sample of 70 bank lending officers, with a response rate of 61.4 per cent. The experimental task involved sixteen explained cases, resulting from all possible combinations of the treatment levels of the independent variables. Respondents were asked to indicate their perceived likelihood, on a scale of 1 (very low likelihood) to 7 (very high likelihood) that management may obtain its preferred resolution to the conflict with the auditor. 50 per cent of these cases present a conflict issue over the disclosure of a subsequent event, and the remaining cases present the materiality of a financial statements amount. The results indicate that the level of competition is not significantly influencing bank lending officers' perceptions of the auditor's capability to refuse to go along with management demands.

Gul (1989)[22] examined the impact of five variables including competition within audit market on the perceptions of auditor independence from the point of view of bank lending officers in New Zealand. A questionnaire survey was used to collect data. The sample comprised 64 bank lending officers who are responsible for lending decisions. The experimental task required respondents to assume that a hypothetical company is an applicant for a loan and the bank requests audited financial statements to support their loan application. The overall credibility of the audit report is dependent on the auditor's independence. Independence is defined as the ability of the auditor to remain objective and carry out their audit work with an unbiased mental attitude. Respondents were presented with eight scenarios on which they were required to indicate their response on a seven-point Likert scale from 1(little or no confidence on auditor's independence) to 7 (very high confidence on auditor's independence). The level of competition is depicted as either "high" or "low". An overall response rate of 76 per cent was obtained. The results indicate that the existence of high level of competition is perceived as increasing and enhancing the auditor's independence.

Competition in Gul's (1991)[23] study is categorised into two levels: "high" and "low". High level of competition is depicted in the experimental task as *"a large number of auditing firms aggressively pursuing expansion programs in terms of increasing their client numbers"* and low competition is portrayed as *"a few or no competing firms in*

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[22] Refer to page (39) for further details about his study.
[23] Refer to page (39) for further details about his study.

the audit market" (p: 171). The results indicate that when competition is high, bank lending officers perceive that the auditor is more likely to resolve the conflict in favour of the client, than when competition is low. This is attributed to the fact that bank lending officers believe that the client may attempt to switch to another auditor who is more compliant and thus the auditor who fears being replaced is less likely to withstand management pressure. However, these results are conflicting with the findings of Knapp (1985).

Gul and Tsui (1992)[24] examined the effect of tendering on bankers' perceptions of auditors' talent to refuse to accept management wishes in an audit dispute position. "*In the audit tendering process, audit firms are invited to tender for an audit engagement, and obviously pricing becomes a major consideration*" (p: 182). Audit tendering is a competitive reaction to reduce the audit fees incurred by the audit client. In the research instrument, audit tendering was depicted as "yes" or "no" treatment levels. Respondents were requested to make a subjective judgment on a seven-point scale on the likelihood that the auditor would resolve the matter in dispute according to the client's preferred action. The results indicate that audit tendering is found to have no effects on bankers' perceptions of auditors' ability to oppose client manager's demands. Therefore, the results show that the practice of audit tendering does not affect bankers' perceptions of auditor independence.

Patel and Psaros (2000)[25] investigated the effect of three factors including competition on the perceptions of auditor's independence from the perspective of four groups of students from different countries. In the research instrument the level of competition was categorised into two levels: "high" and "low". High competition indicates that many professional accounting firms were actively marketing their services to increase the number of clients. Low competition means that there are only a handful of professional accounting firms and they are not actively perusing expansion programs to increase the number of clients. Respondents are asked to indicate by circling the appropriate response on a nine-point Likert scale as to the likelihood that external auditors' independence may become impaired in the light of these two levels of competition. The results indicate that a high level of competition is a significant factor

[24] Refer to page (44) for more details about their study.
[25] Refer to page (45) for more details about their study.

which is perceived to increase the threat that auditors may compromise their independence.

Umar and Anandarajan (2004) examined the effect of several factors including competition, across the USA and Australia. A questionnaire was utilised. The sample of the study consisted of 680 CPAs in the USA and 640 CAs in Australia. The experimental task involved a hypothetical company (HC), and respondents were asked to assume that they are auditors for that company. A list of 14 questions represented pressures that auditors may face within a competitive audit market. Respondents were also presented with a ten-point Likert scale from 1 (not likely) to 10 (highly likely) on which they were asked to indicate the likelihood of their agreeing with the controller's (HC) position (where a lower likelihood indicates greater independence). In the experimental task, the competitive pressures were depicted as: (1) pressure to retain the client and (2) pressure to conform. One of the scenarios presented was "other audit firms are interested in having the (HC) as a client, and there is a possibility that if you do not agree with the controller's position, the (HC) may terminate the audit firm's services". The results indicate that competition caused pressure to retain the client and pressure to conform, therefore competition was perceived to affect auditor independence.

Abu Bakar et al.'s (2005)[26] survey required the subjects to circle "yes" or "no" if the competition level had any effect on auditor independence. The competition was depicted on two levels: "higher" and "lower". Respondents were required to indicate their level of response on a scale of 1 to 7, where 1= strongly agree and 7 = strongly disagree as to the effect of the two levels of competition. The results indicate that over 74 per cent of respondents perceived that competition among audit firms affect audit independence. The results also show that the high competitive audit market leads to a lack of auditor independence. The results also indicate that the level of competition among audit firms is ranked, according to its importance in influencing the auditor's independence, the third factor among the six factors examined. However the results lack reasoning as to why commercial loan officers perceive that a high level of competition undermines independence.

[26] Refer to page (40) for more details about their study.

Competition, in Alleyne et al.'s (2006)[27] study, is depicted as a high level of competition within the external audit market. In the research instrument, respondents were asked to indicate on a five-point Likert scale the direction of influence that a high level of competition may have on the auditor's independence. Alleyne et al. conclude that competitive audit fee discounting, low-balling (setting the initial audit fee below the current standards of audit cost) competition that results in budget pressures imposed by audit firms on staff, and competition among audit firms, negatively affect auditor's independence. The results indicate that a high level of competition within the external audit market is perceived to negatively affect the perceived auditor independence. Therefore, high competition undermines auditor independence. However, Alleyne et al. failed to highlight the reasons behind such perceptions which respondents held with regard to the effect of competition on the auditor's independence.

In the research survey used by Awadallah (2006)[28], the audit market competition is depicted into two treatment levels; that of high level competition among audit firms and low level. The results indicate that overall, the subjects perceived that the level of competition was a greater problem for audit firms in a dispute with the management of an audit client with weaker corporate governance structures than for stronger corporate governance structures. The results also show that subjects perceived that higher competition was a greater problem for smaller audit firms in a dispute with the client management of an audit client having a weak corporate governance structure. Therefore, the results indicate that high competition in the audit market leads to a lack of auditor independence.

The results from the above empirical studies have produced conflicting evidence regarding the effect of audit market competition on perceived auditor independence. For instance, it has been argued that competition has no effect on the perceived auditor independence, (e.g. Knapp, 1985; Gul and Tsui, 1992; DeAngelo, 1981a). However, there is an adverse view that a highly competitive audit market enhances the auditor's independence (e.g. Gul, 1989). However, there is a different view that high audit competition increases the risk of auditor independence becoming impaired, (e.g. Shockley, 1981; Shockley, 1982; Patel et al., 2002; Abu Bakar et al., 2005; and

[27] Refer to page (41) for more details about their study.
[28] Refer to page (40) for more details about his study.

Alleyne et al., 2006). Further, it has been concluded that high audit market competition increases the risk that auditors may resolve the dispute situation in favour of their client's management, therefore impairing their independence (e.g. Gul, 1991; and Awadallah, 2006). This may be due to low activity enforcement within the developing economies. It can be argued that within a highly competitive audit market, smaller auditors appear to find it difficult to oppose client pressure, especially when providing a non-audit service (which is examined in the subsequent section).

3.7 Non-Audit Services

The controversy surrounding the issue of providing non-audit services along with audit services to audit clients was highlighted over four decades ago by Carmichael et al. (1968). They argue that providing both non-audit services and audit services to the same client may impair the independence of auditors. The recent corporate failure of Enron, on the other hand, has driven the debate over the issue of non-audit services, and led regulators to prohibit the supply of some non-audit services by auditors for the purpose of safeguarding the auditor's independence as well as to protect stakeholders such as investors and creditors. In this vein, the AICPA enacted a new law to regulate the auditor's independence, namely the Sarbanes-Oxley (SOX) Act (2002). In addition, there is extensive research concerned with the effect of non-audit services on the quality of audits and the independence of auditors.

Shockley (1981)[29] examined the effect of four variables including non-audit services on the perceptions of auditor's independence. Shockley presumes that audit firms rendering non-audit services to their clients are perceived as having a greater risk of losing their audit independence than are auditors who do not provide non-audit services. In the experimental task, non-audit service is depicted to two levels, namely: non-audit service is provided, or non-audit service is not provided. The results indicate that audit firms which provide non-audit services to audit clients are more likely to lose independence than audit firms which do not provide such services. This result is consistent with the expected effect of rendering non-audit service to audit clients.

[29] Refer to page (38) for more details about his study.

Pany and Reckers (1988) examined the effect of non-audit services on the perceptions of financial statement reliability as well as perceived auditor independence from the view point of loan officers and financial analysts. The sample consisted of 192 loan officers and 104 financial analysts. The research instrument involved a loan application that loan officers were required to review. In the experimental task, financial analysts were also required to evaluate information relating to a possible common stock investment. For instance, loan officers were asked to either approve or reject a loan application based on the level of non-audit services provided by auditors to loan applicants. Respondents were also asked, among other questions, how confident they were that financial statements are free from the effects of material fraud. Respondents were also required to indicate their level of confidence that the auditors are independent (i.e. able to act with integrity and objectivity in performing the audit) on a ten-point Likert scale from 1 (No confidence) to 10 (Extreme confidence). The results indicate that providing non-audit services is perceived to affect investment or corporate lending decisions. In other words, the perceptions of audit independence and the perceived reliability of audited financial statements are threatened.

Gul (1989)[30] examined the impact of non-audit services on the perceptions of auditors' independence from the perspective of bank loan officers. In the experimental task, non-audit service is categorised as providing non-audit services or not providing non-audit services. The bank loan officers perceived that providing non-audit services enhanced the auditor's independence. In other words, the results indicate that bank loan officers have more confidence in the independence of auditors who supply non-audit services in addition to audit services. However, the results of Gul's 1989 survey indicate the contrary to the results of Gul's 1991 survey. Gul, in 1991,[31] examined the effect of several factors, including non-audit services on the bank loan officers' perceptions of the auditor's ability to withstand management pressure in an audit dispute. Non-audit service is categorised into providing non-audit services and not providing non-audit services. The results indicate that auditors who provide non-audit services are perceived to be more likely to resolve the dispute in favour of the client management than auditors who do not provide non-audit services.

[30] Refer to page (39) for more details about his study.
[31] Refer to page (39) for more details about his study.

Firth (1997) examined the relationship between the agency costs and the decision to purchase non-audit services and auditor independence. He based his analysis on the presumption that companies with higher agency costs purchase smaller levels of consultancy services from their auditor. This is because the appearance of an auditor's independence may be at risk if the client faces high agency costs and if the auditor has strong economic bonds to the client. The sample data consisted of financial statements for years ending in 1993, from 500 British industrial listed companies. Data was extracted from DataStream, Exstat, annual reports, and the Financial Times. The research experiment involved a development of the mathematical model of the decision to purchase non-audit services. The results indicate that firms that encounter potentially higher agency costs are in a position to be more alert about jeopardising the appearance of auditor independence. Consequently, such firms will acquire a lower level of non audit services from their auditor.

Canning and Gwilliam (1999) examined the effect of non-audit services (NAS) on the perceptions of auditor independence from the perspective of three groups of financial statements users. These users comprised corporate lenders, investment managers and financial analysts. A total of 196 questionnaires were mailed. Semi structured interviews were also conducted within the Irish commercial environment. The response rate was 75.5 per cent. In the research instrument, NAS is depicted in five statements. Respondents were asked to indicate their level of agreement as to the effect of these on the auditor's independence on a five-point Likert scale, from 1 (strongly agree) to 5 (strongly disagree). Respondents were presented with the following task: the auditor's independence is decreased if NAS are: (1) provided to audit clients by personnel involved in the audit, (2) provided to audit clients by a separate department within the audit firm, (3) provided to non-audit clients only, (4) are not provided at all, (5) provided by the auditor to all clients but full disclosure is made in the client's financial statements. The results indicate that perceptions of auditor independence are significantly impaired when NAS are provided to clients by personnel involved in the audit.

DeFond et al. (2002)[32] investigated the veracity of regulators' concerns as to whether non-audit fees impair auditors' independence. They mainly examine the association between non-audit and audit fees paid to incumbent auditors, and auditors' independence, where auditor independence is surrogated by the propensity of auditors to issue going concern audit opinions. The sample being used in the study was all available proxy statements filed with the Securities and Exchange Commission (SEC), between the fiscal year starting on February 05th 2001 and the year ending October 31st 2001. The study focuses on financially stressed firms in evaluating the auditor's ability of issuing a first-time going concern opinion. A model was developed to investigate whether there was a link between non-audit and audit fees and auditor independence, measured as the propensity of auditors to issue going concern opinions. The results indicate that there is no relationship between non-audit services fees and the auditors' tendency to issue a going concern report. They also found no relation between audit fees and the auditor's propensity to issue a going concern opinion. It has also been suggested that market-based institutional incentives, such as reputation loss and litigation costs, promote auditor independence and outweigh the economic dependence created by higher fees.

Kinney et al. (2004) examined the effect of non audit services on the quality of financial reporting. They investigated the fees for restating previously audited financial statements. The examination was based on the assumption that fees for financial information system design and implementation (FISDI), internal audit, and certain other non audit services purchased from a registrant's audit firm, increased the probability of the restatement of audited or reviewed financial statements. Data was extracted from Lexis-Nexis News, and Form 8-K library files, including all interim and annual restatements (GAAP violation restatements) announced from January 1st, 1995, through December 31st, 2000. The usable sample consisted of a total of 979 fee-years affected by restatements. The experimental task involved an analysis of the restatement of previously issued and independently audited financial statements which were misstated under GAAP. The results indicate that there was no significant association between fees for FISDI or internal audit services and restatements. The results also indicate that there was a significant positive relationship between audit fees, audit-related fees, and unspecified non-audit services fees and restatements. The

[32] Refer to page (46) for more details about their study.

unspecified non-audit services fees may create an economic dependence that may result in more restatements and that there are insufficient compensating financial reporting quality enhancements to offset the dependence.

Quick and Warming-Rasmussen (2005) examined whether restrictions on the non-audit services would increase the perceptions of auditors' independence from the perspective of five groups in Denmark. These groups are state authorised auditors, managing directors, bank loan officers, private shareholders and business journalists. A Total of 927 questionnaires were distributed to collect data. An overall response rate of 51.9 per cent was obtained. In the research experiment, respondents were asked to indicate their level of agreement that if the auditor provided non-audit services in addition to audit services; s/he was not sufficiently independent from the client's management. Respondents were presented with a five-point Likert scale from 1 (completely disagree) to 5 (completely agree). The results indicate that shareholders, bank loan officers and journalists perceive that providing non audit services in addition to audit services negatively affects auditors' independence. However, auditors and managing directors do not suffer from a lack of independence.

Hay et al. (2006) investigated the effect of non-audit services, along with audit services to clients, on auditor independence. They examined three characteristics, these being: the relation between audit fees and non-audit fees; the effect of non-audit fees on auditors' propensity to issue a qualified or modified audit report; and whether or not the level of non-audit fees affects the stability of audit tenure. They developed a regression model with data from financial reports of the top 200 New Zealand companies, both listed and unlisted. According to their findings, there is a positive relationship between audit fees and non-audit fees. Audit fees and non-audit fees are jointly determined, and the strongest determinant of each of them is size. The results show that there is no significant relation between audit qualification or modification and non audit fees, which does not indicate a lack of independence. The results also indicate that there is a potential for an appearance of impairment of auditor independence. This may occur when the incumbent auditors jointly provide audit and non-audit services.

Ruddock et al., (2006) examined whether or not providing non-audit services by incumbent auditors is linked to earning management (reduced conservatism) in

Australia. In this respect, reduced conservatism is expected to occur when high levels of non audit services result in reduced auditor independence and, eventually, lower-quality auditing. Data used in their study consisted of 4061 firm-year observations of the Australian Stock Exchange (ASX) listing firms contained in the Aspect Financial database with a June 30 year-end, from 1993 to 2000. The experiment involved a mathematical regression model. The results indicate that higher than expected levels of non audit services are not associated with a reduced conservatism. Therefore, the study concluded that recent legislative interference aimed at restricting the supply of non-audit services is unlikely to result in increased independence, even though independence in appearance may be improved.

Habib and Islam (2007) examined the effect of non-audit services on the auditor's independence in Bangladesh. The experimental task involved a mathematical model developed through two phases. In the first phase, a multivariate regression model was employed to determine the possible factors that influence the non-audit service purchase decision. The second phase examined the association between non-audit fees and financial reporting quality (the relation between the supply of non audit services and reduced auditors' independence). Data consisted of 530 firm-year observations from 1996-1999. The results indicate that large firms, firms with growth prospect, and multinational subsidiaries purchase more non-audit services. The results also indicate that there is no adverse impact of non-audit services on auditors' independence.

Gul et al. (2007) examined the impact of non-audit fees on auditor independence in the light of audit tenure. They examined whether or not high non-audit fees impaired auditor independence. Data on audit fees was extracted from the Standard and Poor's database; this included all firms for which audit fees data were available. Data on auditor tenure was obtained from the Compustat database. The sample consisted of 4720 US firms for the years 2000 and 2001. The experiment involved a development of a mathematical regression model. The results indicate that auditor independence may be negotiated when auditors with a short rotation receive high non-audit fees. They also found no significant association between non-audit fees and earnings management, when auditor rotation is lengthy.

Huang et al. (2007) examined the relationship between different types of non-audit services fees and the quality of financial reporting in the USA. Data was extracted from the Audit Analytics database and Compustat database. The sample consisted of 3622 and 3269 observations in 2003 and 2004 respectively. The total available fee data is from 6891 SEC filings in 2003 and 2004. The experiment involved a mathematical model that was employed to analyse the relationship between non-audit fees and biased financial reporting. In the experimental task, the discretionary accrual model was applied to measure the effect of earnings management on the biased financial reports. The results indicate that there is marginal evidence that biased financial reporting by clients is lower in clients with a higher value of tax fee ratio or other non-audit fee ratio. The results also indicate that there is no association between different types of non-audit services fees and biased financial reporting. The results also show that auditors are more conservative in the post-SOX era.

Joshi et al. (2007) examined the effect of non-audit services on the perceptions of auditors' independence as perceived by two groups: auditors and client executives. A questionnaire survey was used to collect data from audit firms and listed companies in the Kingdom of Bahrain. The sample comprised 42 listed companies on the Bahraini Stock Exchange and 11 audit firms operating in the country. Out of the 42 listed companies, 36 were local companies and the remaining were overseas companies. Out of the 11 audit firms, seven were international audit firms and four were local audit firms. The experimental task included questions related to the extent to which respondents believed that non-audit services provided by / obtained from company auditors are beneficial to the client and the extent to which such services may impair auditors' independence. Respondents were asked to indicate their level of response on a four-point Likert scale (4 = to a very large extent; 3 = to a large extent; 2 = to a limited extent; 1 = least extent / not at all). Non-audit services were presented in 15 types (e.g. asset valuations, legal services, forecasts and management consulting). A response rate of 66.7 per cent was obtained from listed companies, and 17 responses were received from auditors. The results indicate that auditors' independence is impaired, to a limited extent only, when auditors provide non-audit services along with audit services.

A review of the above empirical studies has generated conflicting evidence as to the effect of non-audit services on the perceptions of auditors' independence and the quality of financial reporting. For example, it has been argued that audit firms which provide non-audit services to audit clients are more likely to lose independence than audit firms which do not provide such services (e.g. Shockley, 1981; Pany and Reckers, 1988; Canning and Gwilliam, 1999; Quick and Warming-Rasmussen, 2005; Hay et al., 2006; Joshi et al., 2007). These results are supported by the view that auditor independence may be threatened when auditors with shorter rotation gain high non-audit fees but not when auditor tenure is long (e.g. Gul et al., 2007). It has also been argued that when auditors provide non-audit services, they are perceived to be more likely to resolve the dispute in favour of the client management than auditors who do not provide non-audit services (e.g. Gul, 1991). Moreover, non-audit services fees may create an economic dependence that leads to more restatements which decrease the perceived reliability of audited financial statements (Kinney et al., 2004).

However, DeFond et al. (2002) showed that there is no association between non-audit services fees and the auditors' propensity to issue a going concern opinion (independent attitude). It has therefore been attributed that audit market regulatory requirements, such as auditors' legal liability and litigation costs, sustain auditor independence and offset the economic dependence incurred by higher non-audit fees. In other words, auditors are more conservative in the post-SOX era (Ruddock et al., 2006; and Huang et al., 2007). Contrary to these views, Gul (1989) argues that bank loan officers have more confidence in the independence of auditors who supply non-audit services in addition to audit services. Moreover, Habib and Islam (2007) show that there is no adverse impact of non-audit services on auditors' independence in Bangladesh. This might be due to the fact that the multinational subsidiaries, based in this country, possess sound corporate governance and strong institutional incentives. These incentives are highlighted in the following section.

3.8 Legal Incentives in the Audit Market

Liability of auditors is one of the legal incentives that may monitor auditors' behaviour. In this respect, Favere-Marchesi (2000, p: 137) states that '*in general a liability regime consists of civil liability, criminal liability, and professional sanctions. Whether auditors are exposed to civil or criminal liability usually depends*

on the nature of the offence committed by the statutory auditor. Generally, auditors are subject to civil liability when they breach contractual and/or civil obligations'. It has been argued (for example, Samsonova, 2006) that the absence of an adequate system of auditor liability, the low level of the efficiency of commercial courts, the absence of a mandating authority to implement formulated regulatory mechanisms, policies, or legislative initiatives are all obstacles faced by the development of an audit profession in Russia. Moreover Jennings et al. (2008) argue that the issuance of an unqualified internal control audit report makes auditors more liable in the instance of fraud.

Trompeter (1994) examined the effect of audit partner compensation schemes, generally accepted accounting standards and partners' perceptions of litigation and client loss risk on audit judgments in situations involving auditor-client conflict. A questionnaire and scenario cases were conducted amongst 107 audit partners in six large accounting firms in the USA, with a response rate of 50 per cent. In the questionnaire, the respondents were presented with questions that related to the effect of the perceived risks of litigation and client loss resulting from subordination to the client. Respondents were presented with a seven-point scale from 1 (strongly agree) to 7 (strongly disagree) and included the effect of allowing the client's preferred treatment on the risk of litigation and the effect of disallowing the client's preferred treatment on the risk of client loss. The results indicate that audit partners are not willing to resolve the dispute in favour of their client, and litigation and the fear of losing the client safeguard the auditor's objectivity.

Shafer et al. (1999) examined the effect of formal sanctions on the perception of auditors' independence. A questionnaire survey was conducted amongst 2150 members of (AICPA). A response rate of 15 per cent was obtained. The experiment involved a scenario describing an auditor-client dispute in which the auditor was required to give an unqualified report. The scenario presumed the auditor resolved the dispute in favour of the client. Respondents were presented with three possible types of sanctions: litigation risk; disciplinary risk and peer review risk. Respondents were asked to estimate the likelihood that the auditor in the scenario would be exposed to these threats, on an 11-point scale anchored on "very unlikely" and "very likely". The results indicate that the effect of litigation risk (auditors being sued) and

the risk of adverse peer-review were perceived as a deterrent to unethical behaviour. However, the threat of disciplinary action by professional bodies is not perceived as an important deterrent to aggressive reporting. Therefore, one could argue that legal sanctions work as incentives for auditors to maintain their objectivity, and thus safeguard their independence.

Favere-Marchesi (2000) examined the effect of national laws and regulations on four aspects: (1) the independence and incompatibilities issues faced by auditors; (2) the appointment and termination of statutory auditors; (3) audit reporting and (4) the liability of statutory auditors. A questionnaire survey was conducted amongst seven Asian countries which represent The Association of Southeast Asian Nations (ASEAN). The research instrument included an open question format. Respondents were asked about laws and regulations which regulate these aspects; the independence and incompatible activities, appointment and termination of statutory auditors, relationships of auditors with the client, liability of auditors towards the client and third parties, and contents of the audit report. The results reveal that there is a diverse legal environment among ASEAN countries. Moreover, due to a lack of rules and legal incentives, auditors' independence is seriously compromised in some countries by allowing financial relationships, personal or family relationships, and commercial relationships with their clients.

Wahdan et al. (2005) investigated the legal framework surrounding the auditing profession in Egypt and the problems faced by the profession. They utilised a questionnaire survey of 32 auditors including 13 auditors of academic backgrounds and 19 practitioners within 17 audit firms, including international audit firms. They also conducted 18 interviews with the participants. Their results indicate that there is a gap between legislation and the practice of the profession regarding its organisation and compliance with accounting and auditing standards. The results also indicate that there is a gap between the auditing standards and the actual auditing practice. According to Wahdan et al., the gap results from the differences in belief between auditors and users, and the differences in auditors' expertise and experience. Users of accounting information contained in financial statements are unaware of the importance of auditing report types and are dissatisfied with the Egyptian auditors' performance.

Tahinakis and Mylonakis (2005) examined the effect of four variables on the perceptions of auditors' independence: legal liability, negotiating auditing fees, professional sanctions and fear of losing reputation and client. A questionnaire survey was conducted amongst three groups: 315 certified auditors, 180 bank loan executives and 106 financial analysts in Greece. In the research instrument, respondents were asked to show to what extent the potential threat of legal liability was perceived as a factor that affects the probability of an audit firm maintaining its independence. Respondents were presented with seven available responses from 1 (greatly decreases) to 7 (greatly increases). The response rates of 23, 25, and 31 per cent were received from auditors, bank executives, and financial analysts respectively. The results indicate that all three groups considered the legal liability to have a significant impact on the likelihood that auditors would preserve their independence.

Choi and Wong (2007) examined the effect of a country's legal environment on the auditor's role in mitigating agency problems or reducing information asymmetry. Data was extracted from the worldscope database. The sample includes the auditor name and firm-specific financial data of larger firms of 39 countries. The study presumes that the positive relation between a firm's capital-raising needs and the appointment of a Big 5 auditor decreases with the strength of a country's legal environment, and the positive relation between a firm's risks and the appointment of a Big 5 auditor decreases with the strength of a country's legal environment. The results indicate that auditors may serve as a good corporate governance substitute when legal protection of outside investors is weak. In addition, risky firms may find that using quality auditors as a signalling device is affordable when litigation costs are lower in a weaker legal environment. Moreover, debt and equity issuance and firm risks '*are more positively associated with Big 5 auditor appointments in weak legal environments than they are in strong legal environments*' (p: 40).

From the above review, it can be argued that legal incentives (such as formal sanctions, auditor liability to third parties) work as internal monitoring mechanisms which may safeguard the auditor's objectivity. National laws also play a major role in regulating the audit profession in general (e.g. Samsonova, 2006) and safeguarding the auditor's independence in particular (e.g. Trompeter, 1994; Shafer et al., 1999; Favere-Marchesi, 2000; Tahinakis and Mylonakis, 2005). In addition, lack of

enforcement of regulatory requirements may create an expectation audit gap. For instance, Wahdan et al. (2005) argue that there is a gap between legislation and the practice of the profession regarding its organisation and compliance with accounting and auditing standards in Egypt. However, Choi and Wong (2007) conclude that risky firms may find that using quality auditors as a signalling device is affordable when litigation costs are lower in weaker legal environments. The legal audit environment contains an audit committee, in the audited entity, which is investigated in the next section.

3.9 Audit Committee

An audit committee is defined as being '*a sub-committee of the main board of directors of a company, usually formed from non-executive directors and charged with matters relating to financial reporting and audit*' Spira (1999, p: 231). The recent corporate collapse of Enron for example, and its related audit failure of Arthur Andersen, has led professional bodies worldwide to take action regarding corporate governance reform. For instance in the UK, the ICAEW (2003), the combined code on corporate governance, agreed that an audit committee and auditors' main principle should be that the board set up formal and transparent activities for considering how they should apply financial reporting and internal control principles and retain an appropriate relationship with the company's auditors. One of the audit committee's roles, according to this code, is to reassess and monitor the external auditor's independence and objectivity and the effectiveness of the audit process, taking into account pertinent UK professional and regulatory requirements.

For instance, an empirical study conducted by Knapp (1987) investigated the factors that may affect the willingness of audit committees to support auditors involved in technical disputes with management. These factors are: backgrounds of audit committee members, size class of the audit firm, nature of the audit conflict issue, and the client's relative financial condition. A questionnaires survey was utilised to collect data. An overall response rate of 50 per cent was received. Respondents were provided with eight cases describing auditor-management conflicts and instructed to assume that s/he is a member of the audit committees of the companies involved in the disputes and that the audit committee, in each case, has been asked to arbitrate the dispute. Respondents were required to report the likelihood that they

would support the auditor, rather than management. A seven-point, equal-interval Likert scale was used to indicate their response. The results indicate that audit committee members have a propensity to support auditors rather than management when audit disagreements occur. Audit committee members who are corporate managers tended to be more supportive of auditors than members from other backgrounds.

Porter and Gendall (1998) investigated the incidence of audit committees in private and public sector entities; the reasons for their adoption; their membership; administration and functions; the extent of disclosure relating to audit committees in corporate annual reports; the attributes likely to enhance their effectiveness and their perceived advantages and disadvantages. 540 questionnaires were mailed to four groups. These groups were namely: external auditors - partners of the Big Six and 'middle tier' firms of chartered accountants and senior personnel from New Zealand; internal auditors from both private and public sector entities; chairpersons of the governing bodies of public listed companies; financial analysts, stockbrokers, bankers and financial journalists. An overall response rate of 67 per cent was obtained. The results indicate that 60 per cent of public listed companies and significant public sector entities had audit committees, which were regarded as good corporate practice, and they generally hold between four and seven members. The results also show that audit committees are perceived to play a major role in achieving good corporate governance.

The study of Abbott et al. (2000) examined the relationship between firms with audit committees which meet the minimum thresholds of both independence and activity, and the incidence of Securities Exchange Commission (SEC) sanctions for fraud and aggressive accounting. Audit committee independence (including at least one non executive member) and its activities refer to, for example, audit committee meetings and overseeing external auditors. The sample consisted of 78 firms 43 of which were subject to SEC sanctions for alleged international fraud between 1980 and 1996. They developed a regression model to examine the effects of the variables, including the audit committee. The results indicate that the presence of an audit committee which excludes employees and meets at least twice annually is associated with a lower probability of sanctions by the Securities and Exchange Commission. Their

study concludes that there is no significant relationship between the percentage of outsiders on the overall board and incidence of sanctions.

In terms of the relationship between auditor selection and audit committee characteristics, Abbott and Parker (2000) conducted another study which examined the association between audit committee characteristics (member independence and activity) and the engagement of an industry-specialist auditor. They defined the active and independent audit committees that had higher demand for auditor quality because of concerns about reputational losses that may result from lawsuits. The industry-specialist auditors, one the other hand, who specialise in the client's industry, are expected to provide higher audit quality than do non-specialists. The sample consisted of 500 firms listed on the NYSE, AMEX, or NASDAQ exchanges. A regression model was developed. The results show that 70 per cent of the sample has audit committees comprising non-employees that met at least twice in 1994. The results also indicate that firms with audit committees that do not include employees and that meet at least twice annually are more likely to use industry-specialist auditors.

Al-Twaijry et al., (2002) examined the role that audit committees play in the Saudi Arabian corporate sector. Their study is based on interviewing 33 different participants including academics, external auditors and internal auditors. Interviewees were asked about the work and effectiveness of audit committees. The results indicate that an expectation gap exists between what audit committees are expected to do and what they actually do. More explicitly, audit committees in Saudi Arabian joint stock companies lack the power to control the board of directors. Audit committees in Saudi Arabia do not have the power to enhance the role of external and internal auditors nor are they able to protect shareholders.

Carcello and Neal (2003) examined the relationship between audit committee independence and disclosure choice for financially distressed US firms. They developed a mathematical model for their investigation. The sample consisted of public held manufacturing companies experiencing financial distress during 1994. The 138 target companies are those with a level of financial distress at which auditors might reasonably be expected to question the going-concern status of the entity. The results indicate that there is a significant positive association between the percentage

of affiliated directors on the audit committee and the optimism of firms' going-concern disclosure. The results also show that there is a relationship between audit committee independence and financial reporting quality. Thus this reflects the added value of independent audits.

Joshi and Wakil (2004) investigated the extent to which listed companies in Bahrain have complied with the audit committee's regulations and recommendations. One of these recommendations is that all audit committee members should be considered independent when they have no relationship to the audited corporation. A questionnaire survey and interviews were conducted with all 41 listed companies on the Bahraini Stock Exchange (BSE). The findings indicate that all banks have established audit committees in accordance with the Basel Committee requirement. Audit Committees were established in large companies, especially those involved in foreign operations. The results indicate that, in terms of the audit committees' membership, almost all respondents have three or more members in their committees. In addition, the majority of the respondents have a written charter with guidelines related to audit committees' functions. However, not all the charters have complete guidelines. The results also indicate that most of the respondents have quarterly audit committee meetings, and that audit firms perceive audit committees to have a vital role in improving corporate governance in Bahrain.

Al-Mudhaki and Joshi (2004) examined the role that audit committees play in the corporate governance in India. They investigated the composition, focus and functions of audit committees, effects of meetings and the criteria adopted in the selection of members of audit committees by Indian listed companies. The research approach used to collect data was a questionnaire survey and a sample of 286 listed companies from 1999-2000. The results indicate that only 56.2 per cent of companies have established an audit committee even though it is mandatory. 68.3 per cent of the companies that established audit committees have between three and six member on their committees while only 14.6 per cent of companies have independent non-executive directors on their audit committees. These results indicate a lack of independent representation on the audit committees among Indian companies.

Pandit et al. (2006) examined audit committee reports in terms of to what extent the reports contained voluntary disclosures that would indicate compliance with the

relevant requirements of the Sarbanes-Oxley Act (SOX) (2002). The sample consisted of one hundred companies from those listed on the New York Stock Exchange in 2005. The experimental task involved an observation and contents analysis of the actual text appearing under the heading "audit committee report". The results show that all audit committees have membership ranging from 3 to 7 members; 82 per cent of the audit committee reports mention that the members of the committee are independent; 16 percent of the reports claim that all the members on the committee are financially literate; 26 percent of the audit committees mention that the number of meeting ranges from 4 to 32; 47 percent of audit committees mention responsibilities of appointment, retention and compensation of the auditor; 49 percent of such reports contain an explicit conclusion that the auditor is independent; 59 percent of such reports contain a reference to the pre-approval of non-audit services. The results also indicate that the responsibilities of audit committees have increased significantly, especially with the SOX Act (2002).

Stewart and Munro (2007) examined the impact of audit committee existence, the frequency of audit committee meetings and the auditor's attendance at meetings on aspects of the external audit. Respondents comprised audit partners, directors, senior managers and mangers from the Big Four and four middle-tier auditing firms located in three capital cities in Australia. A total of 120 research instruments were mailed to respondents. Respondents were provided with a scenario including a pharmaceutical company listed on the Australian Stock exchange a year ago. The number of times the audit committee met was categorised as: twice a year with the audit partner required to attend both meetings; six times a year with the audit partner required to attend only the first and the last meeting; six times a year with the audit partner required to attend all meetings. Respondents were asked to respond on a scale of one to seven to indicate the perceived impact of audit committee and its meetings on audit risk. An overall response rate of 61 per cent was obtained. The results indicate that the audit committee, the regularity of committee meetings and the auditor's presence at meetings were significantly associated with a decrease in perceived audit threat.

Mangena and Tauringana (2008) examined the relationship between audit committee characteristics and the decision to engage external auditors to review published interim reports. The sample comprised 262 interim reports published in the period

2001-2002 of non-financial companies listed on the London Stock Exchange. A regression model was used for data analysis. The results indicate that external auditor participation was positively associated with the proportion of independent non-executive directors on the audit committee. The results also indicate that there was a negative relationship between external auditor engagements with audit committee members' shares ownership. Mangena and Tauringana also found a positive association with the financial expertise of the audit committee.

From the above studies concerned with the role an audit committee plays in monitoring the audit function in general and the auditor's independence in particular, it can be argued that regulatory bodies, researchers and academics have paid considerable attention to the impact of audit committees on perceived auditor independence. Professional bodies have enacted several reforms concerning the audit committee's role in the quality of financial reporting. For instance in the USA, the SOX Act enacted in (2002). Empirical studies on the other hand have produced mixed evidence as to the impact of an audit committee on perceived auditor independence. For instance, a group of studies concluded that the audit committee plays a major role which is perceived to reduce the audit risk and enhance audit quality (e.g. Knapp, 1987; Porter and Gendall, 1998; Abbott et al., 2000; Abbott and Parker, 2000; Carcello and Neal, 2003; Joshi and Wakil, 2004; Pandit et al., 2006; Stewart and Munro, 2007; Mangena and Tauringana, 2008).

However, other empirical studies report that audit committees in Saudi Arabian joint stock companies lack the power to control the board of directors. Audit committees in Saudi Arabia do not have the power to enhance the role of external and internal auditors nor are able to protect shareholders (Al-Twaijry et al., 2002). Similar to this evidence, Al-Mudhaki and Joshi (2004) concluded that only 14.6 per cent of companies investigated had independent non-executive directors on their audit committees. The low percentage of non executives in the audit committee indicates a lack of independent representation on the audit committees among Indian companies. Since both studies represent less developed economies, one could argue that regulatory requirements, in developed countries such as the USA, UK and Australia, may not be applicable to immature professional accounting professions. Moreover, in addition to the variations in the monitoring function of audit committees across

countries, there is also a difference in the mandatory audit tenure which is explored in the subsequent section.

3.10 Audit Tenure

The tenure of auditors has received much attention in auditing literature. For instance Mautz and Sharaf (1961) argue that a long association with the audit client may cause complacency, lack of innovation, and a less rigorous audit. This means that over a long period of time in which an audit firm provides audit services to the same client, this may lead to a development of a close relationship between audit firms and their clients. Consequently, such close relationships may have an impact on the perceptions of auditor independence. However, Arrunada and Paz-Ares (1997) state that compulsory rotation makes audits more costly. The reason being is that it increases production costs and reduces competition within the audit market. They also conclude that the increase in costs derive from the fact that a significant amount of specific assets is destroyed, which need to a large extent be rebuilt in each rotation. They also argue that the rotation is not justified by its effects on audit quality, because the rotation may damage the two main determinants of quality, which are the auditor's technical competence and independence.

The regulatory requirements regarding audit firm rotation in the UK is stated as follows: "*There is no regulatory requirement for UK listed companies to change auditors after a number of years in office. However, where the same audit engagement partner acts for an audit client for a prolonged period, a familiarity threat is recognised as arising. As a result, the UK regulatory requirements are that, for listed companies, the audit engagement partner cannot act for more than seven years and cannot return to that role for a further five years.*" ICAEW (2002, p: 1). The UK regulatory change emerges as a result of the collapse of Enron and its auditors, Arthur Anderson. Such audit failure also led regulators worldwide to consider means for enhancing auditor independence. For instance, in the USA, the Congress enacted the Sarbanes-Oxley Act (SOX) 2002 to restore the confidence of investors' perception of auditor independence. The SOX Act (2002, p: 29) states that "*Audit Partner Rotation-It shall be unlawful for a registered public accounting firm to provide audit services to an issuer if the lead (or coordinating) audit partner (having primary responsibility for the audit), or the audit partner responsible for reviewing*

the audit, has performed audit services for that issuer in each of the 5 previous fiscal years of that issuer." In addition, although in the USA the SOX Act requires a study to investigate the expected benefit and costs of a mandatory rotation of registered public accounting firms Dart, (2007, p: 85) argues that the 'mandatory audit firm rotation is not yet required.'

The impact of the long-term auditor-client relationship is examined by Firth (1981). He investigated the effect, of long associations between the external auditors and their clients, on perceived auditor independence from the perspective of UK bankers. A questionnaire survey to collect data was used. The sample consisted of 1700 bankers. Participants were provided with details of auditor-client relationships (independent and non-independent auditor-client relationships). The experimental task required participants to review the information and state the maximum amount they would lend to the company (i.e.the client involved in the experimental task). An overall response rate of 74 per cent was obtained. The results indicate that the majority of respondents would lend less when long-term relationships exist than when they do not. In addition, the subjects perceived the auditor to be independent when a setting involving a long-term audit firm-client relationship existed. More specifically, Firth (1981, p: 182) argues that lengthy audit tenure "*may provide benefits in that* [it] *could well lead to the audit being completed more quickly and thus audit fees may be reduced and [audit client's] company profitability increased.* [Moreover] *the audit may be undertaken with greater expertise and valuable advice may be given to the* [audit client]".

Shockley (1981)[33] examined the impact of audit tenure on the perceived auditor independence from the perspective of four groups. Audit tenure was categorised into two levels: five years or less, and more than five years. The results indicate that long association between the auditor and client has no impact on the perceived auditor independence. Similarly, Teoh and Lim (1996)[34] examined the impact of audit tenure among other variables on the perceived auditor independence. Experimental scenarios were mailed to 100 accountants from public accounting firms and 100 accountants from industry in Malaysia. The audit rotation is defined as retaining an

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[33] Refer to page (38) for more details about his study.
[34] Refer to page (44) for more details about their study.

auditor over five years. Respondents were asked to respond to a scale of 1 to 10, 1 indicating no confidence and 10 indicating high confidence. The results show that non-rotation of audit firm is not a dominant factor.

Another empirical study from Malaysia which casts some light on audit tenure was conducted by Shafie et al. (2004). They examined the effects of audit firm tenure on the issuance of a going concern opinion. The sample consisted of all non-finance distressed companies identified using a list of financial indicators under the ISA 570 (revised) going concern. The ISA 570 (revised) came into force from 1st January 2002. For this reason the year 2002 is selected as the fiscal year under investigation. A total of 187 listed companies in the Kuala Lumpur Stock Exchange, appear to be financially distressed. The experimental task was a mathematical model with a multivariate regression analysis applied, including (among other variables) tenure of audit firm, Big 5 auditors, audit committee, and client size. The results indicate that longer audit tenure has a positive significant association with the auditor's reporting decision. They also conclude that auditors in Malaysia made fewer serious errors or audit failures compared to their model. The results also show that if a client never changes their auditor since being listed in the KLSE, there is a tendency to issue a clean opinion though the client suffers apparent financial problems. Shafie et al. add that "*auditor change would do well, but forcing an unrealistic audit firm rotation might not yield what it hopes for*" (p: 11).

Another study in Malaysia conducted by Abu Bakar et al., (2005)[35] examined the impact of audit firm rotation on the perceptions of auditors' independence from the viewpoint of lending officers. Tenure of audit firm is categorised into two levels: long tenure and short tenure, during which auditors provide audit services to their clients. The former is assumed to threaten independence. The latter is assumed to safeguard it. Respondents were required to respond to these statements to indicate their level of agreement on a scale of one to seven where 1 = strongly agree and 7 = strongly disagree. Respondents were also required to circle yes or no to a question if they perceived the tenure affected auditors' independence. The results show that 90.07 per cent of respondents answered yes to the tenure of audit firms having an influence on auditor independence. The results also indicate that the majority of

[35] Refer to page (40) for more details about their study.

respondents agreed with the statements that long tenure impairs auditors, while most respondents agreed with the statements that short tenure enhances auditor's independence.

In terms of tenure regulation, Carrera et al. (2007) also investigated the consequences of the removal of mandatory audit firm rotation in 1999 in Spain. Their review took the form of historical analysis supported by congressional hearings, financial newspapers and documents produced by professional associations of auditors in the country. They ascertain that mandatory audit rotation did not work in Spain since it was first introduced in 1988 and led to the removal of the requirements of mandatory audit rotation. They conclude that the removal of such a regulatory provision emerges as a process that was never given the chance to work. Mandatory audit rotation was removed not because of its failed practical impact, but because it was politically convenient for a government seeking to secure support for other reforms aside from beliefs about the status of the Spanish auditing profession.

Further, Carrera et al. (2007) reported that the Spanish experience has been used by regulators, professional associations and international auditing firms worldwide to support their stance against mandatory audit firm rotation in the UK, USA and New Zealand. They also state that the rotation policy returned and became prominent at the beginning of 2000. They attributed this return to the fact that the international pressures to reinforce auditors' independence on the aftermath of well known corporate scandals, along with internal pressures derived from some financial scandals in Spain, led to the Spanish authorities reviewing the national framework for auditor independence. It has also been argued by for example Catanach et al. (1999) that the recent international corporate failures have been attributed to poor audit quality associated with a perceived lack of auditor independence. These audit failures are perceived to have occurred because auditors failed to either detect or report material errors in the financial statements. Therefore, mandatory auditor rotation has been suggested as a means of strengthening independence and reducing the incidence of audit failure. However, both studies of Carrera et al. (2007) and Catanach et al. (1999) lack empirical research which may provide detailed evidence of the mandatory audit rotation.

Additional empirical research was conducted recently in the USA by Kaplan and Mauldin (2008). They examined the impact of audit firm rotation as well as partner rotation on non-professional investors' perceived auditor independence. They dichotomised the tenure as 5 years and 26 years. Their investigation involved two experiments. The first experiment embraced a sample of 163 MBA students. Participants were asked whether or not they believed earnings would be lower when the audit firm is rotated, compared to when the audit partner is rotated (5-year rotation). An overall usable manipulation check questions are 125. The second experimental task involved 73 MBA students. 55 participants completed the experiment. Participants in the second experiment were asked whether earnings correction beliefs will be lower when the audit firm is rotated compared to when the audit partner is rotated (26-year rotation). The results indicate that non-professional investor's perceptions are not associated with the form of auditor rotation. They conclude that audit firm rotation is not perceived to strengthen perceptions about auditor independence in a setting involving a long-term audit firm-client relationship.

In terms of longer audit tenure, the results of Kaplan and Mauldin (2008) are shared by those of Ghosh and Moon (2005). In this respect, Ghosh and Moon examined the association between tenure audit firm and the audit quality from the viewpoint of three primary users of audited financial statements, these being investors, independent rating agencies and financial analysts. Their experimental task included mathematical models. Data was obtained from the list of publicly traded firms in the 2001 Compustat annual files (active and research). The results indicate that in general, audited financial statements, and in particular reported earnings, are perceived as more reliable for firms with a longer auditor tenure.

Jennings et al. (2006) examined the relationship between the perceived auditor independence and liability and rotating audit firms according to SOX Act legislation. Jennings et al investigated whether or not perceptions of auditor independence and auditor liability were incrementally influenced by strengthening corporate governance and by rotating audit firms. An experimental scenario was conducted amongst 49 judges. Respondents were presented with a hypothetical company that was required by the SEC to restate its financial statements for aggressive accounting practice (over stated income) during the fiscal year 1999. The company was already a client with an

audit firm which also provided non-audit services to the company. The auditor issued a clean report. Respondents were asked to indicate to what extent they believed the external auditor was independent on 10-point Likert scale. The results indicate that auditors are less likely to be liable for fraudulently misstated financial statements, suggesting that strengthening corporate governance and rotating audit firms leads to enhanced auditor independence.

Alleyne et al. (2006)[36] examined the effects of twelve variables including the tenure of the audit firm on perceived auditor independence from the viewpoint of auditors and users. A questionnaire survey was used to collect data. In the experimental task, audit tenure was depicted as a lengthy one (more than ten years), and respondents were asked to indicate their response on a five-point Likert scale from 1 (seriously undermines independence) to 5 (strongly enhances independence). The sample included 66 auditors and 148 users in Barbados. The results indicate that lengthy tenure negatively affects perceived auditor independence. Auditor independence, on the other hand is perceived to be enhanced by the existence of a regulatory policy of rotating audit partners.

Abdul Nasser et al. (2006) examined the effect of audit tenure and switching behaviour on auditor independence in Malaysia. The study mainly investigated whether or not extended audit tenure with the same client created a close relationship that may decrease the confidence in the audit quality and impair auditor independence in Malaysia. The experimental task included a mathematical model to test for the relationships between auditor switching and type of audit firm, client size, and length of tenure. The sample consisted of 297 companies listed on the Kuala Lumpur Stock Exchange (KLSE). Data was collected from the KLSE Research Institute Database for a period of 11 years from 1990 to 2000 inclusive. The financial statements and audit reports of the sample firms are also utilised. The results indicate that large audit firms are found to secure longer tenure. Financially distressed clients, on the other hand, are more likely to switch audit firms because smaller auditors would be more unwilling to qualify their reports or show opposing views with their clients for fear of being fired and thus losing a client.

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[36] Refer to page (41) for more details about their study.

The study of Gates et al. (2007) examined the effects of audit firm rotation and / or audit partner rotation on individuals' confidence in the quality of audited financial statements. Audit firm rotation is the regular change of an audit firm by another audit firm that provides audit services. In their study, they utilised two case study scenarios. The participants were a combination of second year MBA students at a metropolitan university, and third-year law students from another metropolitan university in the USA. Both groups were participants from the business and legal community (MBA & law students). The results of Gates et al. (2007) indicate that rotating the audit firm increases confidence in reported earnings, compared to only rotating the audit partner or no rotation. In other words, rotating the audit partner of the same audit firm does little, if at all, to enhance confidence in the information contained in the financial statements. That is to say, rotating audit firms prevents the creation of relationships between auditors and their clients. Thus, this increases the auditor independence.

The above empirical studies have produced mixed evidence as to the impact of audit tenure on the auditor independence. A group of studies indicate that non-rotating audit firms (long association between the auditors and their clients) is not perceived to impact on the auditor's independence (e.g. Firth 1981; Shockley 1981; Teoh and Lim 1996). Other groups conclude that audited financial statements are perceived as more reliable for firms with longer auditor tenure (Gosh and Moon, 2005; Kaplan and Mauldin, 2008). On the contrary, another group of studies shows that rotating audit firms is perceived to enhance auditor independence (Abu Bakar et al., 2005; Gates et al., 2007; Alleyne et al., 2006; Jennings et al., 2006; and Abdul Nasser et al., 2006). It can therefore be argued that perceptions of auditor independence vary across countries as a result of their differing regulatory audit systems. Moreover, Hofstede's (1980) wide-ranging work on the consequences of cultural differences across nations, confirms substantial variations on certain predispositions to particular phenomena, a fact that inevitably has impact on practices in finance and accounting. The following section examines the effect of national culture on the auditor's independence.

3.11 Culture and the Auditor Independence

Culture is defined as 'the collective programming of the mind which distinguishes the members of one group or category of people from another' Hofstede (1997, p: 5).

The programming is apparent in the values and beliefs of a society. Values are the propensity of an individual to prefer certain states of affairs over others (Cohen et al., 1993). In this respect, the influence of culture on the accounting profession is introduced by several researchers (Gray, 1988; Salter and Niswander, 1995). In addition, Smith and Hume (2005) state that "accountants of individualistic (high IDV[37]) societies are more likely to adhere to personal principles even if the results are detrimental to the organisation. [Whereas] accountants of collectivistic (low IDV) societies are more likely to subordinate individual values for those that benefit their organisation" (p: 217). Cultural values, therefore, are classified across societies. These values are: (1) uncertainty avoidance; (2) individualism versus collectivism; (3) masculinity; (4) power distance (Hofstede, 1980), and (5) long versus short term orientation (Hofstede, 1997). The uncertainty avoidance and the individualism versus collectivism will be discussed in the following two paragraphs, as these two values seem to be relevant to the issue of this research.

The uncertainty avoidance according to Hofstede (1980) measures the way cultures face an unknown future with differing anxiety levels, need for security, and reliance upon experts. It has been argued that auditors, as experts from cultures with a higher tolerance for ambiguity (with weak uncertainty avoidance) may be more likely to focus on the content of the issue rather than on the form alone, than auditors from cultures having strong uncertainty avoidance. In the same vein, it has been argued (for example, Cohen et al., 1993) that in the international auditing environment the uncertainty avoidance construct has implications for ethical decision making. Moreover, individuals from cultures having weak uncertainty avoidance fail to accept consistent procedures. Individuals from strong uncertainty avoidance cultures '*focus on rules to the exclusion of asking whether the procedure leads to an ethical outcome*' (p: 11).

Individualism describes the way individuals relate to and live within their society and their nuclear family unit, while collectivist societies live around extended families, clans, and tribal units. Being a member of such societies, an individual inherits certain values and behaviours which in turn affect the society's other institutions including education, religion and politics (Cohen et al., 1993). For instance, auditors

[37] IDV stands for Individualistic societies according to Hofstede classification.

from individualistic cultures are expected to maintain independence, which is the freedom from the influence of others. This concept is a cornerstone of the Anglo-American audit. However, collectivistic auditors appear to reflect the contrary of the Anglo-American Independence. This is because auditors from collectivistic cultures obey the custom and tradition of their extended family and clans and therefore they are not free from the influence of others. It has been argued (for example, Cohen et al., 1993) that individualists fail to consider the '*existence and the efficacy of the self-correcting mechanism of family face*' [while collectivistic auditors are unwilling to] *blow the whistle on a member of the group to force a correction of the problem in a timely manner*' (p: 11).

There are several empirical studies which focus on the impact of ethics and culture on the accounting profession. For instance Patel and Psaros (2000)[38] examined the influence of culture on the perception of auditor independence from the view point of final year undergraduate accounting students. A questionnaire was used to collect data in order to determine the effects of culture on the perceptions of auditor independence. The participants of their study are final year undergraduate accounting students in the UK, Australia, India and Malaysia. The results indicate that there are some significant differences across the four countries. Two countries that are the most different appear to be Malaysia and India. Indian participants perceived a smaller loss of auditor independence, whereas Malaysian participants perceived a greater loss of audit independence. However, the perception does not differ between UK and Australian participants. Therefore, one may suggest that national culture affects the perceptions of individuals and therefore auditors and users of financial statements.

Lord and DeZoort (2001) examined whether social influence pressures within the accounting firm affected auditors' willingness to sign off financial statements that are materially misstated. They also investigated the effects of organisational commitment, professional commitment and moral development as three factors that may impact individual responses to social influence pressure. The study examined the effects of inappropriate obedience and conformity pressures generated from within the accounting firm on auditors' decisions to sign off financial statements that are

[38] Refer to page (45) for more details about their study.

materially misstated. They investigated, using a scenario case study, whether organisational commitment, professional commitment and moral development affect auditor decisions under social influence pressure. The participants of their study were 171 audit staff members from one international accounting firm. They collected data in four different cities in different geographic regions within the USA. The results indicate that, on the one hand, obedience pressures significantly increase auditors' willingness to sign off an account balance that is materially misstated. On the other hand, conformity pressures do not affect the auditors' decisions. In addition, the organisational commitment and the professional commitment do not affect the auditors' decision.

Patel et al. (2002) examined the effect of cultural values on professional judgments of accountants in solving auditor-client dispute. A questionnaire survey was employed to collect data from Australia, India and Malaysia, with response rates of 60, 65, and 68 per cent respectively. The sample comprised senior accountants from the Big Six / Big 4 audit firms in these countries. The experimental task involved an auditor-client dispute scenario similar to the one used by Knapp (1985)[39]. In the scenario, the auditor-in-charge decides that the unrecorded liabilities will be ignored for the purposes of financial statements and the auditor's report. Respondents were asked to indicate their response to the probability that they would make the same decision as the auditor-in-charge, on a seven-point Likert scale from 1 (highly probable) to 7 (highly improbable). The results indicate that Australian respondents were less likely to assent to clients than Indian and Chinese Malaysian respondents. Therefore, one could argue that Australian auditors are perceived to be more independent than those of India and Malaysia.

Rutledge et al. (2003)[40] examined among other variables, whether respondents of three countries within one region, those who share similar environmental, economic, political and cultural factors, have similar perceptions of auditor independence. In the experiment, by testing for effects of the grouping variable "similar cultures", the results indicate that there is no significant difference between auditors or financial analysts in Saudi Arabia, Kuwait, and the United Arab Emirates regarding the impact of each of the four factors on their perception of auditor independence. The results

[39] Refer to page (49) for more details about his study.
[40] Refer to page (46) for more details about their study.

indicate that there is no difference on the perceived auditor independence across the three countries. Therefore, perception of auditor independence is sensitive to national culture.

Gendron et al. (2006) examined the influence of changing work conditions on accountants' commitment to professional ethics in Canada. An online survey questionnaire was conducted. The experiment involved questions presented to professional accountants about the relationship between accountants' ethical commitment towards auditor independence and features of their work and cultural environment. The sample consisted of 7000 Chartered Accountants from four provincial institutes: Alberta, British Colombia, Nova Scotia and Quebec. The results indicate that accountants' independence and commitment is, on average, relatively high, thereby suggesting that professional accountants are then considering independence as a key element of public accounting and also rather accessible to its regulation through control mechanisms. The results also indicate that public accountants' independence commitment is lower than that of non-public accountants and independence commitment is resistant to the influence of the individual's involvement in accountancy's core area of work.

Askary (2006) examined the effect of national culture on accounting professionalism in twelve developing countries by using Gray's 1988 model of accounting values and Hofstede's cultural study. The sample consisted of 132 annual reports from sample companies of these countries under investigation. Information about these countries' accounting environments was also incorporated into the analysis. The study presumed that developing countries under the study demonstrated statutory control for their accounting authority, which is described as ranging from statutory control to professionalism. The results indicate that the accounting authority is different according to the cultural diversity across countries. The study concludes that 'culture in different societies can strongly impact national accounting systems' (p: 102). In addition, Askary et al. (2008) suggest that cultural and country-specific values affect the accounting system development of which an independent audit is a part.

Kosmala (2007) examined the impact of culture on the construction of auditor independence in two countries within the Central and Eastern Europe (CEE) region - Poland and the Czech Republic. Semi-structured interviews and observations were

combined to extract data gathered in September 2001 and April 2002 in different cities within these two countries. Respondents were asked (among other questions) about the cultural values that are important to them as professionals and as individuals Respondents were also asked to suggest any aspects of their national culture (at country level), or economic conditions that may impact on auditor independence. The study reveals heterogeneity of auditor independence. Independence in Poland is related to individualism, while in the Czech Republic, it is related to collectivism. The study also reveals that the concept of auditors' independence in the CEE region has its foundation in the European laws, and therefore the rules-based approach to auditor independence prevails. The results also indicate that socio-economic, political, and regulatory changes have led to compulsory audits.

Tsakumis (2007) examined the influence of national culture on accountants' application of accounting rules across two countries which are Greece and the USA. A questionnaire survey was conducted with the cooperation of the Greek Body of Sworn-in Accountants and the South Carolina Association of Certified Public Accountants. Respondents represented accountants from international, national and regional firms. In the research instrument, respondents were asked to assume that they were accountants for a fictional company engaged in a lawsuit and to come to a decision to recognise or disclose a contingent asset or contingent liability based on the guidelines of accounting standards. Response rates were 45 and 73 per cent received from Greek and US respondents respectively. The results indicate that Greek accountants would be less likely to disclose the existence of both contingent assets and liability than US accountants. Therefore the results suggest that 'national culture does play a role in accountants' disclosure judgment [and that] uniform accounting standards may not result in similar disclosure decisions being made across countries' (p: 44).

Cultural influence on auditing in Libya is addressed by Ritchie and Khorwatt (2007). They state that '*the auditing profession in Libya is exposed to three distinctive influences, legal imperatives, quasi-legal professional requirements of the nationally recognised body and socio-cultural imperatives of family, tribe and community*' (p: 41). Besides this, Ritchie and Khorwatt argue that auditors in such a society are lifetime members of these groups and are expected to provide respectful faithfulness

and support for the rules, traditions and beliefs in return for protection and support. Similarly, Agnaia (1997) states that *'Libyan social environment is characterized by the extended family, clan, tribe, village and Islamic religion. These play a major role in the community's life and people's relationships with each other'* (p: 120).

It has also been argued (Ritchie and Khorwatt, 2007) that the audit client in Libya is most likely to be from the same socio-cultural group. Auditors, as members of such groups with their underlying behaviours and inherited values, on the other hand, face possible pressure to be forced to certify misstated financial statements or to resolve audit conflict in favour of client management. Therefore, one could argue that the auditing profession can be influenced by personal connections, community attitudes, beliefs and customs which may make it difficult for auditors to resist any pressures from their social and personal connections and relative relationships, in the case of audit dispute. As a consequence, auditors may find it difficult to maintain their objectivity and independence. In addition, Hope et al. (2008) highlight an association between national culture and financial reporting quality through the firm's choice of auditor. In other words, firms in more secretive cultures are less likely to hire a Big 4 auditor.

The above review has generated the vision that culture has an effect on the audit profession in general and on the independence as a behaviour value of an individual auditor. Furthermore, according to Hofstede's classification of cultural values, national culture impacts on the accounting profession and auditors' independence across countries or regions (e.g. Patel and Psaros, 2000; Patel et al., 2002; Rutledge et al., 2003 Askary, 2006; Gendron et al., 2006; Kosmala, 2007; and Askary et al., 2008). In addition, Retchie and Khorwatt (2007) argue that the auditing profession in Libya is influenced by cultural values of family, tribe and community. Moreover, Tsakumis (2007) points out that national cultures play a role in accountants' disclosure judgment and that homogeneous accounting standards may not result in similar disclosure decisions being made across countries. Further, Lord and DeZoort (2001) argue that obedience to social pressures significantly increases auditors' willingness to sign off financial statements that are materially misstated.

3.12 Gaps in the Literature and Hypotheses Development

From the previous literature review, seven gaps have been identified. Firstly, even though some factors in the environment such as audit firm size, audit fees size and competition which affect the perceptions of auditors' independence (objectivity) have been considered, some other aspects of national culture that are prevalent in the country which may affect perceptions of auditor independence have been neglected. Therefore, this study considers cultural influence on audit quality and independence because it affects the social system in the country. According to Hofstede (1980), culture influences the customs and values of societies, including attitudes and perceptions, and consequently accounting and auditing practice.

Secondly, in terms of the subjects (participants), the previous studies suffer some limitations and problems. For instance; first, the participants of Lord and DeZoort (2001), Rutledge et al. (2003), Alleyne et al. (2006) and Awadallah (2006) are auditors. That means these studies consider the perceptions of auditors (preparers) only toward their independence. Therefore omitting perceived independence of major users of financial statements may not reflect a clear picture of auditor independence. This might also be regarded as a biased viewpoint of their independent status. Therefore, studying the issue of auditor's independence by adding another point of view of other users may produce different results.

Thirdly, it has to be borne in mind that more than a decade has elapsed since the studies of for example, Firth (1980); Pany and Reckers (1980); Firth (1981); Shockley (1981); Dykxhoorn (1982); Knapp (1985); Knapp (1987); Pany and Reckers (1988); Gul (1989); Gul (1991); Gul and Tsui (1992); Bartlett (1993); and Teoh and Lim (1996) were conducted. Various changes and events have occurred during that time, which may invalidate the results, such as the collapse of Enron and the passing of SOX as a consequence of that collapse. Fourthly, the subjects of Patel and Psaros, (2000); Gates et al., (2007) and Kaplan and Mauldin (2008) are students. These studies consider the perceptions of students towards auditor independence. The respondents therefore may be regarded as an unsophisticated group of users, referring to students as not having the practical experience or a clear vision that may enable them to express their perceptions towards the auditor's independence. Fifthly, the research approach and techniques used by for example DeFond et al. (2002); Carcello

and Neal (2003); Abdul Nasser et al. (2006); Hay et al. (2006); Ruddock et al. (2006); Huang et al. (2007) and Mangena and Tauringana (2008) are models which attempt to determine whether there are some factors which are perceived to have an impact on auditors' independence. Those models may not be able to provide what financial statements' users perceive towards some aspects and factors which may have an impact on auditor independence and the perceived reliability of audited financial statements.

Sixthly, the subjects of Abbott et al. (2000); Abu Bakar et al. (2005); Alleyne et al. (2006); Hay et al. (2006) and Gates et al. (2007) are from a culture that may differ from the culture where this study is conducted (the Libyan audit market). Therefore, there is a high likelihood that the perceptions of the participants in these studies may not have reflected the behaviour of the professionals. Finally, although Choi and Wong (2007) revealed the important role that auditors play in a weak legal environment, there is a shortage of studies which could reveal the importance of the influence of regulation and the enforcement and implementation of law in some audit markets, especially those emerging and developing ones. Therefore, this research aims to investigate the impact of legal incentives on the auditor's independence and the perceived reliability of audited financial statements. Therefore, studying more and / or other factors affecting auditors' independence and conducting such a study in a different context may produce another outcome contributing to this interesting field. Therefore, the current study aims to overcome previous studies' problems and thus the following hypotheses have been developed:

3.12.1 Audit Firm Size: Hypothesis Development

This study presumes that OILMAs' (owners, investors, lenders, managers and auditors) perceived auditor independence and the reliability of audited financial statements are positively affected by audit services performed by larger sized audit firms. In other words, when an audit service is performed by a Big 4 audit firm, perceived auditor independence and reliability of audited financial statements increase. Stated formally (in an alternative form):

H_1: OILMAs' perceived auditor independence (PAI) is positively affected by large audit firm size.

H_{1a}: There is a consensus among OILMAs regarding the positive effect of a large audit firm size on the PAI.

H_{1b}: OILMAs consider financial statements to be more reliable when audited by one of the Big 4 audit firms than when audited by a large local audit office.

3.12.2 Audit Fees: Hypothesis Development

The review of the perceptions of auditors' independence literature reports mixed evidence as to the effect of audit fee size on the auditor independence and this issue is not solved. Therefore, there is still a need for further research, especially within an emerging economy. It is assumed that when audit fees from one client represent a high proportion from the total audit revenue; the auditor becomes dependent on such clients as a source of income. For instance, Dodge (1990) highlights three points: (1) a practice should not derive too great a part of its fee income from one client or group of connected clients; (2) attempts to ensure that recurring fees from one client do not exceed 15 per cent of gross fees; and (3) if a member's income depends on the profits of a branch relying on a single client for more than 15 per cent of its gross fees, a partner from another office should take the final responsibility for any report in respect of that client. The economic bond between auditors and their clients may lead users to suspect the objectivity of such auditors. Therefore, this study proposes that high fees impair auditor's independence. Stated formally (in an alternative form):

H_2: OILMAs' perceived auditor independence is negatively affected when one-client audit fee exceeds 15 per cent of the total audit revenue.

$H_{2a:}$ There is a consensus among OILMAs regarding the impact of high audit fees on the perceived auditor independence.

$H_{2b:}$ OILMAs' perceived reliability of audited financial statements is negatively affected when the one-client audit fee exceeds 15 per cent of total audit revenue.

3.12.3 Competition in the Audit Market Hypothesis Development

As discussed in chapter four, the review of the literature documents conflicting views regarding the effect of competition on auditor independence and the perceived reliability of financial statements. The evidence indicates that competition within developed audit markets seems to be different from that in developing countries' audit

markets, mainly due to the difference of audit market regulation. It is predicted that higher levels of competition in the audit market will impair auditor independence and decrease the perceived reliability of financial statements. Stated formally (in an alternative form):

H_3: OILMAs' perceived auditor independence is negatively affected by a high level of audit competition.

H_{3a}: There is a consensus among OILMAs regarding the impact of competition on the perceived auditor independence.

H_{3b}: OILMAs' perceived reliability of audited financial statements is negatively affected by a high level of audit competition.

3.12.4 Non Audit Services Hypothesis Development

The review of the relevant literature in chapter four reports mixed evidence as to the effect of providing non-audit services, along with audit services, on the independence of auditors and consequently on the reliability of financial statements. Therefore, it has been argued by Tahinakis and Mylonakis (2005) that there is a need for further investigation into the area of non-audit services (NAS). Therefore, this study aims to examine the effect of non audit service provision on the perceived auditor independence and the perceived reliability of financial statements in a developing country. A non-audit service is alleged to create an economic relationship (dependence) between auditors and their clients. Similarly, Kinney et al. (2004) state that regulators and legislators apparently presume that providing certain NAS impairs auditor independence, leads to lower quality audits and increases the likelihood of financial reporting that violates generally accepted accounting principles (GAAP). Thus, it is expected that the provision of non-audit services to audit clients impairs the auditor independence and decreases the perceived reliability of financial statements. Stated formally (in an alternative form):

H_4: OILMAs' perceived auditor independence is negatively affected by the provision of non audit services.

H_{4a}: There is a consensus among OILMAs regarding the impact of NAS on the perceived auditor independence.

H_{4b}: OILMAs' perceived reliability of audited financial statements is negatively affected by the provision of non audit services.

3.12.5 Legal and Institutional Incentives: Hypothesis Development

This study conjectures that a flexible regulatory framework, such as a lack of legal and institutional incentives and a lack of domestic (national) independence standards, will decrease confidence in auditor independence as well as decrease reliability of financial statements. In addition, it has been argued by Gavious (2007) that the revelations of massive corporate scandals have proved the existing rules requiring auditors' independence to be inadequate. Stated formally (in an alternative form):

H_5: OILMAs' perceived auditor independence is negatively affected when the audit market lacks legal incentives and domestic independence standards.

H_{5a}: There is a consensus among OILMAs regarding the impact of a lack of legal incentives and domestic independence standards in the audit market.

H_{5b}: OILMAs' perceived reliability is negatively affected when the audit market lacks legal incentives and domestic independence standards.

3.12.6 Audit Committee: Hypothesis Development

A review of the relevant literature also indicates that there are regulatory requirements which are considered as strategies to protect and safeguard auditor independence, such as the existence of audit committees within the client's company. An audit committee is expected to monitor auditors. An audit committee is also expected to safeguard auditors' independence and prevent any collaboration between auditors and company managers (agents) and thus enhance the perceived reliability of audited financial statements. Stated formally (in an alternative form):

H_6: OILMAs' perceived auditor independence is positively affected by the existence of an audit committee within the client's company.

H_{6a}: There is a consensus among OILMAs regarding the positive effect of the audit committee on the perceived auditor independence.

H_{6b}: OILMAs' perceived reliability is positively affected by the existence of an audit committee within the client's company.

3.12.7 Audit Tenure: Hypothesis Development

The review of the existing literature reports mixed evidence as to the effect of audit tenure on the perceived auditor independence and perceived reliability of financial statements. Although the requirements for the rotation of auditors vary across countries, the majority of these regulatory frameworks require a five-year period. Therefore, this study assumes that such rotation on a five-year basis will prevent the creation of close relationships that may lead auditors and their client managers to collaborate and may mislead shareholders (principals). Moreover, others, for example Catanach and Walker, (1999) and Ghosh and Moon (2005) argue that there is a need for further research to examine the effect of audit tenure on audit quality. Therefore, this study proposes that OILMAs' perceived auditor independence and the perceived reliability of financial statements are positively affected by the audit rotation on the basis of a 5-year auditor rotation. Stated formally (in an alternative form):

H_7: OILMAs' perceived auditor independence is positively affected by a 5-year auditor rotation.

H_{7a}: There is a consensus among OILMAs regarding the positive effect of audit tenure on perceived auditor independence.

H_{7b}: OILMAs' perceived reliability is positively affected by audit rotation.

3.12.8 Social Relationships: Hypothesis Development

Drawing from the proposition of Hofstede (1980) in which cultural values were categorised across countries, and based on Gray's (1988) model which presumes that culture affects accounting systems, and drawing on the empirical results of Salter and Niswander (1995), there is evidence that culture does have an effect on the accounting profession. The existing literature seems to pay little attention to the effect of culture on auditor independence. In this respect, Wood (1996), Tsui and Windsor (2001), and Hudaib and Haniffa (2009) argue that future research is needed to investigate the influence of diverse cultures on auditors' attitude and independence. This study, therefore, predicts that country-specific culture impacts upon auditor independence and consequently on the perceived reliability of audited financial statements. Specifically, auditors from collectivist societies are members of an extended family, clan and community, requiring close social relations between its members. Therefore,

this study infers that independence of auditors from such societies is impaired and hence audited financial statements are less reliable. Stated formally (in an alternative form):

H_8: OILMAs' perceived auditor independence is negatively affected by Libyan social relationships.

H_{8a}: There is a consensus among OILMAs regarding the negative impact of Libyan social relationships on the perceived auditor independence.

H_{8b}: OILMAs' perceived reliability of audited financial statements is negatively affected by socio-cultural relationships.

3.13 Summary

This chapter reviews the auditor independence literature within developed countries and developing one. This review reports mixed evidence as to the effect of the above factors discussed. It also reveals that the bulk of research concerning the issue of auditor independence and the perceived reliability of audited financial statements is conducted within developed countries. In other words, this review highlights a gap in the literature about the independence of auditors in developing countries (see tables 3.1 to 3.3). Therefore, there is scope for more research to be conducted in this area of auditing. This chapter also highlights the hypotheses, which are generated form literature reviewed. Based on the literature reviewed in this chapter, the subsequent chapter addresses the research methodology and design developed to fulfil the current research objectives.

Table 3.1: Studies focus on auditor independence in developed countries

Name	Year	Country	Objectives	Approach & Sample & Response Rate (RR)	Results
Pany & Reckers	1980	USA	Gifts, discount arrangement & client size	Questionnaire, Stockholders, 480, RR 26%	Gifts and discount arrangement affect independence. But client size does not.
Firth	1980	UK	Fees, personal relationships, financial involvement, conflicts of interest.	Questionnaire, auditors, lenders, financial analysts, 750, RR 52 %	Non-independence is perceived to impair investment and lending decisions
Firth	1981	UK	Auditor-client relationships & their impact on bankers' perceptions.	Questionnaire, lenders, 1700, RR, 74 %	Lenders would lend less when long-term auditor-client relation exists.
Shockley	1981	USA	Competition, NAS, audit firm size & rotation.	Questionnaire, CPA, lenders & financial analysts, 277 RR 64%	Competition, NAS, audit firm size are significant, but rotation is not.
DeAnglo	1981a	USA	Low balling	Mathematical model	Low balling doesn't impair independence.
Dykxhoorn	1982	Germany	NAS, Family, Financial, employment, and business relationships	Questionnaire, 110 Lenders & 110 Investment Directors, RR 50, 28 %	Both groups perceive that non-independence affects their lending/investment decisions
Mckinley et al.	1985	USA	Impact of NAS, type and size of audit firm on perceived reliability of financial statements	Questionnaire survey, 900 lenders, RR 29 %	NAS did not significantly affect auditor independence or perceived reliability of FS.
Knapp	1985	USA	Competition, nature of conflict, NAS, client's financial condition	Questionnaire, lenders, 70, RR 61.4 %	Client in good financial condition is more likely to obtain its preferred outcome to an audit conflict than clients in poor condition.
Knapp	1987	USA	Audit committee	Questionnaire, 179 audit committee members, RR 50%	Active audit committee supports auditors when dispute occurs
Pany & Reckers	1988	USA	Non-audit service	Questionnaire, 192 lenders, 104 financial analysts	Non-audit services affect investment decision or credit granting decisions and the perceived reliability of financial statements
Gul	1989	New Zealand	Audit committee, financial condition of client, competition, audit firm size, NAS	Questionnaire, lenders, 64, RR 76%	igh competition enhances independence
Gul	1991	New Zealand	Audit Fee size, NAS, audit firm size & competition.	Questionnaire, lending officers 72 RR % 67	Audit fee size, NAS, audit firm size & competition are significant
Gul & Tsui	1992	Hong Kong	Size of audit fees, financial condition of client, audit tendering	Questionnaire, lenders, 60, RR % 95	large audit fees, large clients make auditors less likely to resist management pressure
Bartlett	1993	USA	Audit fees size, NAS, contingent fees, budget pressures, accounting background	Questionnaire, CPA & lenders, 600, RR 40 %	High audit fees impair impendence
Trompeter	1994	USA	Audit partner compensation	Questionnaire scenario, audit partners, 107, RR 50 %	Audit partners are not willing to resolve the audit dispute in favour of client, due to litigation risk suggesting that safeguard auditor independence

Table 3.1 continued: Studies focus on auditor independence in developed countries

Kilcommins	1997	Ireland	Audit firm size, competition, audit committee, audit tenure, NAS, and client employment	Questionnaire, 196 (lenders, investment managers & financial analysts), RR 75.5 & 15 in-depth interviews,	Auditor independence & reliability of financial statements are perceived to be significantly impaired when audit performed by non-Big 6 audit firm
Firth	1997	UK	Non-audit service and agency cost	Experimental model, 500 British industrial listed firms	Firms with high agency costs are more likely to be cautious about jeopardising the appearance of auditor independence so they purchase a lower level of NAS
Porter & Gendall	1998	New Zealand	Audit committee	Questionnaire, auditors, lenders & other users, 540, RR 67%	Audit committee plays a major role in safeguarding auditor's independence.
Canning & Gwilliam	1999	Ireland	Non-audit services	Questionnaire, lenders, investment managers, financial analysts, 196, RR 75.5 % & in-depth interviews	Auditor independence is impaired when non-audit services are provided to client by staff involved in the audit
Shafer et al.	1999	USA	Formal sanctions (litigation risk, peer review risk, disciplinary risk)	Questionnaire, 2150 AICPA members. RR 15 %	Litigation risk, peer review are perceived as a deterrent to unethical behaviour. Suggesting that legal incentives safeguard objectivity
Abbott et al.	2000	USA	Audit committee	Experimental model, sanctioned firms, 121	Firms with audit committee are less exposed to sanctions
Abbott & Parker	2000	USA	Audit committee & auditor selection	Model & 500 annual reports of listed companies	Firms with audit active committee select industry specialist auditors
Lord & DeZoort	2001	USA	Social pressure	Case study scenario, 171 auditors, from one International firm.	Social influence is significant
DeFond et al	2002	USA	Non-audit services fees	Model, 2001financial statements	No association between non-audit services fees and a going concern opinion
Craswell et al.	2002	Australia	Audit fee dependence	Model, publicly reported audit fee	Audit fee dependence does not impair auditor independence.
Carcello & Neal	2003	USA	Audit committee and disclosure choice	Model, 138 distressed firms	Audit committee maintains financial reporting quality

Table 3.1 continued: Studies focus on auditor independence in developed countries

Kinney et al.	2004	USA	Non-audit services	Experimental model, annual restatements	Unspecified NAS fees may create an economic dependence that leads to more restatements, suggesting that a lack of independence results in poor audit quality
Niemi	2004	Finland	Auditor size and audit pricing	Questionnaire, auditors, 273, RR 57%	Small auditors protect their reputation by maintaining high audit quality
Quick & Warming-Rasmussen	2005	Denmark	Non-audit services	Questionnaire, auditors, directors lenders, shareholders, business journalists, 927, RR 51.9 %	Shareholders, lenders, journalists perceive that providing non-audit services to audit clients impairs auditor's independence, auditors & managing directors do not
Ghosh & Moon	2005	USA	Tenure	Mathematical model, Compustat annual files	Lengthy tenure results in more reliable financial statements
Tahinakis & Mylonakis	2005	Greece	Legal liability, negotiating audit fees, professional sanctions, losing reputation	Questionnaire, 315 auditors, 180 lenders, 106 financial analysts, RR 23, 25, 31 %	All groups perceive the legal liability to have a significant effect on the probability that auditors would maintain their independence
Gul et al.	2006	Australia	Non-audit services	840 firms' year observations. Regression Model	NAS adversely affects investors' perception of the credibility of financial reports. Big 4 auditors, because of reputational capital and litigation costs, are likely to mitigate the adverse effect of NAS
Pandit et al.	2006	USA	Audit committee & SOX 2002 Act	Content analysis, 100 annual reports & audit committee reports	Audit committee plays a major role in hiring auditors, approving of non-audit services
Hay et al.	2006	New Zealand	Non-audit service	Model, top 200 listed & unlisted companies. (1999, 177; 2000, 224; 2001, 243 companies)	There is no significant relation between non-audit services fees and issuance of modified reports.
Samsonova	2006	Russia	Transformation and development of audit profession in Russia	Interviews & auditors	Lack of legal framework which is an obstacle facing the audit development.

Table 3.1 continued: Studies focus on auditor independence in developed countries

Ruddock et al.	2006	Australia	Non-audit services	Mathematical Model, 4061 firm-year observations	Higher level of non-audit services are not associated with a reduced conservatism.
Gendron et al.	2006	Canada	Impact of changing work conditions on accountants' commitment to professional ethics.	Questionnaire + 7000 CA from 4 provincial institutes, 31.6%, 20.5%,20.1%, 11.7%.	CAs' independence commitment is on average relatively high. Thus suggests independence is key element of public accounting. But is lower than that of non-public accountant
Jennings et al.	2006	USA	Tenure and liability	Experimental scenario, 49 judges (at a training course).	Auditors less likely to be liable for fraudulently misstated financial statements
Gates et al.	2007	USA	Rotation & quality of financial statements	Two case study scenarios & students	Rotation increases confidence
Giroux & Jones	2007	England & Wales	Audit fee structure	Regression and multivariate model, 409 multi-function local authorities.	Actual audit fees are usually above the standard fees set by the Audit Commission. Big 4 firms receive lower fees on average than district auditors
Stewart & Munro	2007	Australia	Audit committee	Questionnaire, audit partners, audit managers, directors, 120, RR 61 %	Audit committees reduce the perceived audit risk, suggesting independent audit
Gul et al.	2007	USA	Non-audit services & audit tenure	Mathematical Model, 4720 US firms, audit fee data	High non-audit fees impair independence when auditor is in short tenure
Huang et al.	2007	USA	Non-audit services	Model, fee data, 6891 SEC filing in 2003, 2004	High non-audit fees is not associated with the biased financial reporting, suggestion that auditor more conservative in the post-SOX era
Kaplan & Muldin	2008	USA	Tenure of auditor versus partner tenure	Experimental scenario, MBA students, 73, RR 75 %	auditor rotation is not perceived to strengthen perceptions of auditor independence
Mangena & Tauringana	2008	UK	Audit committee	Model, 262 interim reports listed on London Stock Exchange	Active audit committee is related to external audit involvement to review interim reports
Jennings et al.	2008	USA	Perceived credibility of financial reporting process and legal risk auditors bear when providing internal control audit report	Questionnaire survey and 57 judges (at a training course).	Internal control audits report provide enhanced assurance that intentional misstatements do not exist and also serve to provide elevated protection to the public
Davis & Hollie	2008	USA	Non-audit fee ratio, investors' perceptions of auditor independence and market behaviour	Experimental model, 6 investors	disclosure of non-audit fees reduces the accuracy of investors' perception of auditor independence

Table 3.2: Studies focus on auditor independence in developing countries

Gul	1992	Hong Kong	Financial condition of client, audit fee size, audit tendering	Questionnaire + 40 cross-section Lending Officers.	Financial condition of client, audit fee size are significant
Teoh & Lim	1996	Malaysia	NAS, AC, rotation, audit fees size, disclosure of NAS fees	Questionnaire, public accountants, accountants from industry, 200, RR 69%, 33% respectively.	Most factors affect independence but non-rotating of audit firm is not important factor
Al-Twaijri et al.	2002	Saudi Arabia	Audit committee effectiveness	33 Interviews, external auditors, academics & internal auditors	A gap between what audit committees are expected to do and what they actually do
Shafie	2004	Malaysia	Tenure of auditors	Experimental Model, 187 financially stressed firms.	Lengthy tenure results in issuing clean opinion, while clients suffer problems
Al-Mudhaki and Joshi	2004	India	Audit committee's role in the Corporate Governance (CG)	Questionnaire survey + 286 listed companies 1999-2000. RR 27.3%	Audit committees lack independent non-executives, suggestion absence of audit committee main role
Joshi & Wakil	2004	Bahrain	Audit committee	Questionnaire and interviews. 41 listed companies in BSE. RR 73%	Audit committee plays a vital role in CG
Abu Bakar et al.	2005	Malaysia	Audit firm size, competition, rotation, audit fees size, NAS, audit committee	Questionnaire + 240 Lenders, RR 35.8 %	All factors affect auditor's independence
Wahdan et al.	2005	Egypt	Legal framework surrounding auditing profession	(32 Questionnaire, auditors, academics)+ 18 interviews	Gap between auditing STDs and the actual auditing practice
Awadallah	2006	Egypt	Non-audit service, competition, audit firm size, corporate governance structure of client	Questionnaire, 150 auditors, RR 70 %	All factors are significant, with emphasis on NAS
Alleyne et al.	2006	Barbados	Competition, NAS, audit firm size, AC, financial interests, large client, economic dependence, costs of auditor change, risk to auditor, auditor appointment regulation	Questionnaire, 66 auditors & 148 users. RR 53% & 50.7% respectively.	Economic dependence, high competition, small firm size, lengthy tenure, social structure negatively affecting independence. AC, rotation, risk to auditor arising from poor quality, auditor change regulation are enhancing independence.
Habib and Islam	2007	Banglade sh	Non-audit services	Mathematical model, 530 firm-year observations from 1996-1999	Large firms, growing firms, MN subsidiaries purchase more NAS. No adverse impact of NAS on auditor's independence.
Joshi et al.	2007	Bahrain	Non-audit services	Questionnaire, auditors & directors (42listed firms, 11 audit firms) RR 66.7% & 17% respectively.	Providing non-audit service along with audit service impairs auditor independence

Table 3.3 : Studies focus on auditor independence across countries

Patel and Psaros	2000	UK. Australia. India & Malaysia	National culture & perceptions of auditor independence	Experimental scenario. 298 students, (60.94.66 &78 at lecture time)	National culture affects perceptions of individuals across countries
Favere-Marchesi	2000	Brunei. Indonesia. Malaysia. Philippines. Singapore. Thailand. Vietnam	National laws and regulations	Questionnaire (open question format) 4 national (body) representative of the Big 5.	Diverse legal environment among these countries. Lack of rules and legal incentives. auditor independence is compromised in some countries
Patel et al.	2002	Australia. India & Malaysia	Cultural values & professional judgment of accountants & audit dispute	Questionnaire. accountants (Big 6) RR, 60. 65 & 68	Australian accountants are less likely to assent to clients than Indian and Chinese Malaysian accountants
Rutledge et al.	2003	UAE. SA. Kuwait	National culture & client size. NAS. unpaid client fees. family relationship with clients.	Questionnaire. 370 auditors & 269 financial analysts, RR 40 & 31 %	There is similar perceptions across countries that share similar national culture
Umar & Anandarajan	2004	USA & Australia	Competition, opinion shopping. client and auditor size and client financial health	Experimental scenario. 680 US CPAs & 640 Australian CPAs (hypothetical company experiencing audit dispute) at different levels of competition	Competition cause pressure and independence is affected. Although both countries have different legal systems. dimensions of pressure across countries are similar
Ahmed & Goyal	2005	Bangladesh. India & Pakistan	Pricing of audit services	An ordinary least square model & 566 company annual reports	Audit fees are statistically related to client size. subsidiaries of MNC pay higher audit fees. Affiliates of Big 4 audit firms charge higher audit fees for perceived high quality audit service in the South Asian audit market
Askary	2006	12 countries from the Middle East & South East Asia	National culture impact on accounting profession	Experimental model	According to national culture. Iran and Bangladesh share similar views. Accept Gray's hypothesis of statutory control while rejected in other countries
Choi & Wong	2007	39 countries	Strength of a country's legal system	Firm level data from Worldscope. Multivariate Regression Model. 56.885 firm-year observation.	Auditors play stronger governance role in countries with weak legal environment. Risky firms use quality auditors (Big 5) as signalling device when litigation costs are lower in weak legal context
Kosmala	2007	Poland & Czech Republic	Culture and auditor independence	Semi-structured interview & observation (cultural values that influence independence)	Independence in Poland is related to individualism. while in Czech Republic. it is related to collectivistic society
Tsakumis	2007	Greece & USA	National culture & applications of accounting rules	Questionnaire. Greek & US accountants. RR. 45. 73 %	Greek accountants less transparent. suggesting national culture plays a major role in accountants' disclosure decisions being made across nations
Hope et al.	2008	Firms from 37 countries	National culture and choosing / hiring external auditors	Experimental model	Firms in more secretive countries are less likely to hire a Big 4 auditor

Chapter 4

Research Methodology and Data

4.1 Introduction

The preceding chapter examined the related literature which focuses on auditors independence within developed and developing countries. The review of the relevant literature reveals that the bulk of research is within developed nations and there is a lack of research regarding the issue of auditor independence in developing countries. This chapter is dedicated to discusses the two different methodologies available for researchers. These methodologies are quantitative and qualitative approaches. A comparison is made between the two paradigms. The chosen methodology for the current study is also discussed and justified. This chapter is also devoted to address the development and administration of the research instruments adopted, namely the questionnaire survey which was supplemented by semi-structured interviews. Then it is followed by a discussion of the selection of the population of the current study. This chapter also discusses the statistical techniques used for the data analysis of this research. The final section addresses a summary of this chapter.

In light of this study objectives (addressed in chapter 1), it can be argued that this research paradigm is quantitative in nature. Moreover, the review of the relevant literature also reveals a number of methodologies that might be adopted to examine the PAI and the perceived RAFS. These different methodologies being used in previous studies indicate that both quantitative and qualitative techniques can be used in examining the perceived auditor independence and the perceived reliability of audited financial statements. It has been argued (Kilcommins, 1997) that studies which only employ one method are more exposed to errors related to that particular method than studies which use multiple methods in which different types of data provide cross validity checks. Therefore this study adopts multiple methods (quantitative and qualitative approaches).

4.2 Quantitative and Qualitative Methodologies

There are two philosophies or paradigms which describe the researcher's belief about the world that will be reflected in his or her research. These paradigms are:

phenomenological and positivist (Hussey and Hussey, 1997; Remenyi et al., 1998; and Collis and Hussey, 2003). The paradigm or theory is no more than a traditional wisdom of the subject. Therefore empirical research should be essentially rooted in theory and it is impossible to conduct such research in a meaningful way without the researcher taking a specific theoretical standpoint (Remenyi et al., 1998). The phenomenological research (qualitative) refers to the inductive approach that involves the gathering and analysis of qualitative data (Rudestam and Newton, 2001). Through the inductive approach, researchers are not independent of what is being examined but they are part of it (Remenyi et al., 1998). In contrast, the positivist research refers to the deductive approach (quantitative) which includes the gathering and analysis of quantitative data (Saunders et al., 2007). Within the positivist or deductive approach, researchers seem to be objective analysts and interpreters of a tangible social reality. The deductive approach leads to an analytical test of hypotheses testing or empirical generalisation (Remenyi et al., 1998).

4.2.1 Quantitative Approach

The quantitative methodology is based on the positivist view of the world in which all phenomena may be analysed scientifically and explained through appropriate scientific analysis and has been the dominant tradition within the research community. This ideology of thought believes that social facts are there to be discovered and can be investigated. However, Crotty (1998) argues that a quantitative piece of work can be offered in non-positivist terms. In contrast, there is plenty of scope for qualitative research to be understood positivistically or situated in an overall positivist setting. Quantitative procedures generally revolve around codifying phenomena through a range of methods such as questionnaires or fully structured interviews (Griffin, 1985).

In addition, quantitative research is interested in the aggregation of data which are assigned numerical values. It relies on certain accepted categorisations, which enable the making of generalized statements (Johnson, 1994). In this respect, Rudestam and Newton (2001) argue that quantitative research generally rests upon an 'objectivist' epistemological tradition that knowledge is only of significance if it is based on observations of external reality. According to Robson (2002), quantitative research attempts to neutralise the researchers or to reduce or eliminate their influence on the investigated phenomena as far as possible. In addition, Denscombe (1998, p. 208)

states that *"quantitative data in social research has attractions... because it uses numbers and can present findings in the form of graphs and tables; it conveys a sense of solid, objective research."* Moreover, according to Ragin (1994), quantitative research is well suited for several of the basic goals of social research such as identifying general patterns and relationships, testing theories and making predictions. In other words, Leedy (1993) argues that when the data is numerical, the methodology is quantitative.

The quantitative approach has some advantages, for instance, Patton (2002) points out that the quantitative approach enables the researcher to measure the reaction of a large number of people to a limited set of questions, thus simplifying comparison and aggregation of the data. Moore (2000) states that quantitative research techniques have become very sophisticated and it is possible to take a quantitative approach to many issues that are qualitative in nature. For example, quantitative techniques can be used to measure people's perception, behaviour and attitude. However, the quantitative methodology has some limitations. For instance, Ragin (1994, p. 153) points out that *'while the quantitative approach does have many of the features of a hard science, it would be a mistake to portray this approach as something radically different from the other two strategies.'* In this respect Lee (1992) adds that the quantitative methodology is considered as increasingly inadequate, especially in cross-cultural research. He argues that attention should have been dedicated to search for effective alternatives, and this led to the revival of the qualitative approach.

4.2.2 Qualitative Approach

While quantitative research aims to measure what is happening, qualitative research sets out to explain why it is happening (Moore, 2000). Arksey and Knight (1999) argue that while positivism does little to help us to understand why people act as they do, qualitative approaches direct attention to discover what people think, what happens and why. In this vein, Patton (2002) argues that qualitative research means getting close enough to the subjects and capturing what is occurring. From a practical perspective, the qualitative approach reflects the use of interview techniques. In this vein, Wright (1979) states that interviews can be categorised into structured and unstructured interviews. As for the unstructured interviews, the interview takes the form of discussion procedure without a sequence of questions. In other words, the

interview is flexible to the extent that the interviewer is able to cover different topics within the area of investigation. In addition, Wright (1979) points out that unstructured interviews tend to resemble conversation style with no set questions, following a broad outline of topics. In contrast, the structured interviews are conducted with a sequence of questions in a strict instruction.

Contrary to quantitative researchers, who are regarded as adopting a position outside the investigated social world, qualitative researchers take the role of actors and see the world from their perspective. Therefore, in this type of research, researchers could become insiders and could view the subject's world as participants in the setting. It has been suggested that qualitative research is more likely to be inductive rather than deductive research. It is also believed that qualitative research produces large quantities of data that represent words and ideas rather than numbers and statistics. The qualitative approach is concerned with phenomenological studies which seek to understand human behaviour from the participant's own perspective (Rudestam and Newton, 2001). In addition, Silverman (1970) points out that qualitative researchers place greater emphasis on individual experience and interpretation of the world with a view to seeing and understanding the world as others view and experience it.

It is apparent that the main differences between qualitative and quantitative research is not quality but procedures. In this respect, Bryman (1988) argues that the distinction between quantitative and qualitative research is really a technical issue whereby the choice between them is to do with their appropriateness in answering particular research questions. In qualitative research, results are not typically obtained and generated by statistical techniques or other procedures of quantification. However, in some social research, data may be quantified, but the analysis itself is qualitative, such as census reports (Ghauri et al., 1995). In addition, Taylor and Bogdan (1984, p. 7) state that 'a *qualitative study is not an impressionistic, off-the-cuff analysis based on a superficial look at a setting or people. It is a piece of systematic research conducted with demanding, though not necessarily standardized, procedures.*'

However, qualitative data have some serious weaknesses. For instance, Patton (2002) claims that qualitative research is criticised because it is too subjective. In this type of research, the researcher is the instrument of both data collection and data interpretation, because the researchers are getting close to the subjects and involved in

personal contact with them. Patton (2002) argues that the challenge of analysing qualitative data rests upon making sense of substantial amounts of data. Moreover, Miles and Huberman (1994) believe that qualitative approaches lack validity due to a scarcity of defined analytical methods. Miles (1983) reports that collecting and analysing the data is a highly labour-intensive operation. Arksey and Knight (1999) state that the common objection to qualitative studies has been that the outcomes of these studies cannot be tested but have to be taken on trust.

On the other hand, Ghauri et al. (1995) mention that qualitative methods are generally accepted for inductive and exploratory research. Qualitative methods are also useful as they can lead researchers to hypothesis building and explanation. These methods are also most appropriate when the objectives of the research demand in-depth insight into a phenomenon. According to Strauss and Corbin (1998), qualitative methods can provide better understanding of the phenomenon about which little is yet known. However, Alvesson, as cited in Ahrens and Chapman (2006) stated that "*the potential of working with different metaphors of the interview as a method for either expressing social reality or clarifying objective reality is an area that has been subject to considerable debate and controversy.*" Finch (1986) states that traditional weaknesses with the quantitative approach may be tackled by qualitative procedures and vice versa and that social research is likely to be more convincing if a variety of information is utilised, as commonly collected by a range of methods across the quantitative/qualitative divide. Table 4.1 highlights the differences between the two methodologies.

Table 4.1: Characteristics of the two main Paradigms

Positivistic Paradigm	Phenomenological Paradigm
Tends to produce quantitative data	Tends to produce qualitative data
Uses large sample	Uses small samples
Concerned with hypothesis testing	Concerned with generating theories
Data is highly specific and precise	Data is rich and subjective
The location is artificial	The location is natural
Reliability is high	Reliability is low
Validity is low	Validity is high
Generalises from sample to population	Generalises from one setting to another

Source: Hussey and Hussey (1997).

Since both quantitative and qualitative approaches seem to have strengths and weaknesses, the use of a combination of both approaches should yield a valuable

outcome that enhances the validity of results. Thus, in order to overcome the weaknesses of either approach that may be used separately, a multiple approach that involves a questionnaire survey as a main tool, supplemented by semi-structured interviews, is chosen as a methodology of the current study.

4.2.3 Multiple Approach

Multiple-approach 'triangulation' is defined as *"the combination of methodology in the study of the same phenomenon"* Denzin (1978, p. 291). Bryman (1988) emphasises the need for more than one research instrument or approach to be used in the investigation or measurement of the main variables in a study. This strategy, a combination of quantitative and qualitative approach, is referred to as a triangulation measurement. In addition, controversial disputes about the relationship between quantitative and qualitative methods have led to renewed interest in the use of triangulation or multi-method approaches. Multi-approach "triangulation" has been considered as a technique to gain greater and valid outcomes (Arksey and Knight, 1999). The multiple-approach strategy is considered an effective approach based on the argument that the weaknesses in each single method will be compensated by the counter-balancing strengths of another.

The multiple-approach also can enhance the confidence of researchers in terms of their results (Jick, 1979). In addition, it has been argued that collecting data derived by different methods reduces the chance of making errors. It is also suggested that when triangulation is used for confirmation purposes, the individual strengths, weaknesses and biases of the various methods must be applied in such a way that they counterbalance each other (Arksey and Knight, 1999). In their study about experimental judgment and decision research in auditing, Solomon and Trotman (2003) argue that they consider the use of the multiple approach, in which researchers conduct studies employing different research approaches, as an effective and preferred strategy.

Quantitative and qualitative approaches are combined and used in order to achieve and gain more understanding about the phenomenon under investigation (Creswell, 1995). In this respect, Punch (2000) states that qualitative and quantitative methods should be combined when appropriate. Saunders et al. (2007) add that it is quite usual for a single study to combine quantitative and qualitative methods. For instance semi-

structured interviews may be a valuable way of triangulating data collected by other means such as a questionnaire. In terms of triangulation, Kakkuri-Knuuttila et al. (2008) are concerned with the comparison of interpretive research to the subjective and objective dichotomy which is appearing in the methodological literature of the social sciences. More specifically, their philosophy and analysis that explicates how concepts from different paradigms, such as interpretations, understanding meanings, and causality can successfully co-exist and co-operate within a single study. Therefore, to investigate the perceptions of auditor independence and the perceived reliability of the audited financial statements in the Libyan audit market, both approaches are employed in the current study. Thus, in order to fulfil the objectives of the current research study, the following section discusses the research design which was developed for collecting data needed for the current research.

4.3 Investigative Study

The investigative study involved a two-week travel to Libya in 2007. This entailed several visits to the Central Bank of Libya, the headquarters of all commercial banks, the Libyan Accountants and Auditors Association (LAAA), and the Chamber of Commerce and Industry. These visits revealed that the majority of commercial and corporate businesses are located in the capital, Tripoli. Therefore, banks, companies and auditors who operate in Tripoli represent the target population of the current research. In addition to the preliminary investigation into the Libyan audit market, a pilot testing of the research instrument involved a distribution of 10 questionnaires to PhD students in the Liverpool Management School and one lecturer in accounting and auditing at Manchester Business School. This stage also involved several meetings and discussions with the supervisors. This resulted in positive comments which have been incorporated into the questionnaire that covers four groups of users and a group of auditors which represent the population of this study.

4.4 Population

The target population[41] of the current study comprises five groups. These groups are namely: owners, investors, lenders, managers and external auditors. The owner group represents the owners of privately owned companies (with unlimited liability). The capital of such companies should be at least 15000 Libyan Dinnar with no maximum

[41] A random sampling method was adopted in the design of the sample selection of this study.

limit (GPC / Initiative No. 171, 2006). The Chambers of Commerce Directory (2008) shows a list of 235 owners under this category. However, due to lack of contact details for many of these owners, it reduced the contactable individuals to 106 owners from whom the final list was randomly selected for participation of the current study.

The investor group represents the investors who own no more than 10 percent of privately owned limited companies. The minimum capital of these companies should be at least 100,000 Libyan Dinnar (GPC / Initiative no. 171, 2006). The Chambers of Commerce Directory (2008) showed 128 contactable investors under this category. Several phone calls were made with the target participants who were willing to participate in this study. Since the researcher is a sponsored PhD student, the Libyan government usually provides sponsored students with a letter that is directed to official and other relevant parties asking and requesting for cooperation with students who conduct such surveys. The manager group represents the managers of limited companies as mentioned above. This group was also randomly selected from a list of 94 contactable managers whose details are available in the directory.

The lenders group represents the commercial and corporate loan officers in the five major Libyan commercial banks and all six private banks. The lenders group was randomly selected from the Central Bank of Libya. A list of lending departments across all commercial and private banks working in the capital was provided by a university colleague who works for the Central Bank of Libya. Several phone calls were then made with heads of lending departments of all these banks operating in Tripoli. Due to the nature of lending officers, an exact list was not possible to obtain, however, an approximate total number of commercial and corporate loan officers was provided. The total number across all banks was 113 corporate and commercial lenders.

The auditors group represents 98 external auditors who are members with the Libyan Accountants and Auditors Association and those who are performing audit services in the capital Tripoli. In addition, the auditors group include all four Libyan auditors who represent the Big 4 auditors in Libya. Although law 116/1973, which is the only legislation that regulates the audit profession in Libya, prohibits non-Libyans from providing statutory auditing in the country, the Big 4 auditors became involved in a partnership so that Libyan auditors have become correspondents and partners. In

effect, Libyan auditors' names are used by Big 4 auditors. Moreover, Ernst and Young have established its own branch under the name of Ernst and Young & Partners.

From the above outline, it can be argued that all target groups came under a similar population category which is around 100 individuals. Therefore, and based on the table of minimum sample sizes provided by Bartlett et al. (2001), the minimum drawn sample size required to produce the minimum sample size of each of these groups is 80, thus it was decided to distribute 80 questionnaire to each group (producing a total of 400 questionnaires distributed). It should be noted that lack of reliable postal system in Libya entailed great effort and time to personally distribute the questionnaires as well as to collect them in person. Moreover, there were difficulties faced the researcher during all stages of data collection. For instance, the research had to look for the LAAA after it has moved its headquarters to a new location. Furthermore, the LAAA has no website that may provide its contact information. But, a university colleague cooperated in searching for its telephone number and its new location. In addition, during the follow up visits and collecting questionnaires, the researcher had to wait several hours in front of bankers' offices and auditors' offices.

These groups were chosen because they are regarded as the major and key users of financial statements (Knapp, 1985; Gul 1991; and Beattie et al. 1999a). Moreover, including preparers (managers / agents) and users (shareholders / principals) who would facilitate the examination and comparison of perceptions between these groups within the Libyan audit market (whether a consensus exists between user groups and auditors). Therefore, the development and administration of the requisite instrument for the research approach adopted in the current study is discussed in the following sub-section.

4.5 Research Design

Research design is defined by Ghauri and Gronhaug (2002, p. 47) as "*the overall plan for relating the conceptual research problem to relevant and practicable empirical study.*" They add that the selection of the research design can be considered as the overall strategy to gain and collect the data and information needed. Therefore, one could argue that one of the preliminary steps in undertaking a research study is to develop a research design that is consistent with the research objectives. It can

therefore, be argued that the use of both the questionnaire survey and semi-structured interviews would help in achieving the research objectives. Therefore, the following subsection discusses the arguments for and against these two research instruments.

4.5.1 The Questionnaire

Questionnaire is a way of gathering information or collection of data related to some experiment or structured way to gather information about any phenomena. Questionnaire is a well known instrument to collect data about any study or a survey, de Vuas (1991) "*the questionnaire is a highly structured data collection technique whereby each respondent is asked much the same questions*". Researchers and organizations are using this method of data collection for different purposes. That is, the questionnaire instrument is a mechanism of measurement in social science. Miller (1991) defines the mail questionnaire as "*the mail questionnaire is a list of questions for information or opinion, which is mailed to potential respondents who have been chosen, in same designated manner.*" This instrument of data collection is very popular. This is because it promises to secure data at a minimum of expenses and time. It also entails less time than other techniques.

It can be argued that, there are advantages of using a questionnaire survey. These being: (1) the mailed questionnaire technique covers a wide geographical area and a large population for low costs and less effort Miller (1991). In this vein, Casely and Lury (1981) also point out that the use of sample survey saves costs and time. This is because only a limited number of unites have to be investigated and analysed; (2) the mail questionnaire reaches those informants who may not be easy to locate and interview; (3) greater coverage may yield better validity through larger and more representative samples; (4) tolerates more considered answers; (5) questionnaire is more adequate in situations in which group consultations would more valid information; (6) more adequate in situations in which the respondent has to check information; (7) greater consistency in the manner in which questions are posed; (8) gives respondents a sense of privacy; (9) provides a simple means of continual reporting over time; and (10) curtails the effect of the interviewer Miller (1991).

However, there are some limitations of using the questionnaire technique in data collection. These are: (1) the response rates to mail questionnaire usually do not exceed 50 %. That is, there always is a low response rate to mail questionnaire; (2)

generalizing results beyond the chosen sample of respondents may subject to limitations and boundaries. In other words, those who answer questionnaires may differ significantly from non-respondents; and (3) this tool of data collection is criticised due to many respondents are overburdened by the number of questionnaires reach them Miller (1991).

As a sponsored student, the researcher was provided only with a two-month flight allowances to travel to Libya, February and March 2008, for the purpose of data collection. However, this limited time and resources was one of the major restrictions faced this study. Therefore, it can be argued that cross-sectional research (snapshot) is the most appropriate research design to be conducted in order to fulfill this study objectives. Therefore questionnaire survey complemented by a small sample of semi-structured interviews would be justified in the context of the current study. In this perspective, Hussey and Hussey (1997) argue that cross sectional research can be conducted when there are restrictions of time or/and resources.

Therefore, designing an effective research instrument (questionnaire) which takes into account Libyan accounting and auditing practices, which have a different cultural and political environment than developed and other developing audit markets, makes a significant challenge for this research study. Developing countries, however, are facing a problem of a lack of audit and accounting research (Awadallah, 2006). In addition, Libya as a developing country has no previous research of this kind, thus such scarcity makes it even more challenging for this study. The review of the relevant literature documents that Libya's accounting practice is oriented towards a UK and US accounting practice (Ahmed and Gao, 2004 and Ritchie and Khorwatt, 2007). Therefore, a UK-based or a US audit market research evidence could be a helpful source in developing an effective questionnaire. More specifically, variables from Kilcommins (1997), Beattie et al. (1999a), and Awadallah (2006) were used as initial guides to identify attributes of issues on auditor independence and reliability of audited financial statements within the Libyan audit market. In addition, the Libyan company legislation (Decree 171, GPC 2006) and the Law 116/1973[42] have also been considered. The final stage of the questionnaire design involved discussions and reviews with the research supervisors. This is to ensure that the questionnaire

[42] Refer to Appendix 1 for more details about this law.

instrument would cover all the important issues related to the objectives of the current study.

As a result, twelve themes were identified which form the basic structure of the questionnaire. These themes are namely: (1) importance and use of audited financial statements and audit report in decision making; (2) general perceptions of auditor independence; (3) audit firm size; (4) audit fee size, (5) competition in the audit market; (6) the provision of non-audit services; (7) legal and institutional incentives in the audit market; (8) the audit committee; (9) audit tenure; (10) the influence of national culture; (11) audit dispute; and (12) perceived reliability of audited financial statements. Overall, the questionnaire contains 44 questions.

The research instrument consists of seven sections. The first section is devoted to extracting general data which may help build a profile about the participants and their institutions. This section contains eight questions which cover the following: job title; professional and university qualification; age; experience; training courses and training organisation, entity's ownership; type of business; number of employees. In section two, respondents were presented with two questions; in the first question, in order to introduce the issue of auditor independence, participants were asked whether or not there are any particular instances where they have suspected a lack of auditor independence. The second question presents the eight selected factors (which are discussed in chapter 3) that may lead to suspicions of lack of independence.

Section three[43] is about the use of audited financial statements. This section is not applicable to auditors, which comprises seven questions. The first question required respondents to indicate how often they use audited financial statements for financial decision making such as lending or investment decisions. Respondents were presented with 5 options, which are "always"; "often"; "sometimes"; "rarely" and "never". The second question required respondents to answer the importance they attach to audited financial statements on a 5 point scale starting from 1 (very important) to 5 (unimportant). The following question required respondents to indicate how often they consider reliability of audited financial statements when using them for lending or investment decisions. The fourth question required respondents to indicate how

[43] The current study expands this section which was used by Kilcommins (1997).

often they consider auditor's independence when assessing the reliability of audited financial statements.

The fifth question required respondents to indicate their level of confidence in the reliability of audited financial statements when the auditor is perceived to be not independent. The following question required respondents to indicate how often they consider the auditor's independence when deciding on the amount to lend or invest. The last question in section three required respondents to indicate the impact on the amount that they would lend or invest in the company which has been audited by an auditor who is perceived to be not independent. Respondents were presented with four options: "lend / invest more"; "no effect"; "lend / invest less"; and "would not lend / invest at all."

Section four of the research instrument is assigned to present these factors which are the main focus of this research. In this section, respondents were provided with these factors which are presented in the form of statements, to which respondents were required to indicate their response on a five-point Likert scale[44], where 1 = strongly undermines independence; 2 = undermines independence; 3 = no effect on independence; 4 = enhances independence; 5 = strongly enhances independence. In this same section, respondents were presented with these factors in a dichotomous form. In addition, some variables are depicted into three levels such as audit tenure which is depicted into 10 years, 5 years and less than 5 years. One variable is depicted into four levels which is the non audit service.

Respondents, in part four were also, required to indicate their level of perception as to how reliable the audited financial statements are perceived to be, in each situation in the given statements, on a five-point scale[45], where 1 = "always financial statements considered to be reliable"; 2 = " often financial statements considered to be reliable"; 3 = "sometimes financial statements considered to be reliable"; 4 = "rarely financial statements considered to be reliable"; and 5 = "never financial statements considered to be reliable".

[44] Several studies concerned with the perception of auditor independence use this scale (e.g. Beattie et al., 1999a, Alleyne et al., 2007)

[45] The scale is employed by Kilcommins (1997).

Section five consists of two subsections, one is assigned for auditors groups and the other is dedicated to managers groups. It should be noted that this section is not applicable to the other user groups. The first question of this section required auditors to indicate whether or not they have experienced an audit dispute between them and their audit client(s). In the subsequent related question respondents were presented with reasons, which may cause a dispute, from which they were required to choose. Then followed a question which required the auditors group to indicate whether or not they have independently issued an adverse report as a result of that dispute. In addition, the auditor respondents were asked whether or not issuing an adverse report resulted in losing the audit client. In the second subsection of part five, managers were asked the same questions presented to the auditors but with minor changes in wording applicable to managers so as to extract the dispute, if any, with their auditors and the consequence of such a dispute.

Section six is devoted to finding out the importance that is attached to the external auditor's report. This is from the perspective of all respondents who participated in this research. Respondents were presented with a five-point Likert scale on which they were required to indicate their level of response. The scale starts from 1 = "very important"; 2 = "important"; 3 = "undecided"; 4 = "not important"; 5 = "not important at all". In section seven, respondents were asked whether or not they perceived social relationships between auditors and their clients as having an impact on auditors' independence. Section seven required respondents to indicate their level of response as to the degree of influence of social relationships on a five-point Likert scale. The scale range was: 1 = "strongly undermines independence"; 2 = "undermines independence"; 3 = "no effect on independence"; 4 = "enhances independence"; 5 = "strongly enhances independence". At the end of this questionnaire, space is given for respondents to provide any additional comments they may have on the issues addressed in this questionnaire[46].

The questionnaire was interpreted to Arabic[47] under the auspices of an Arabic language specialist. The interpretation process also involved the advice and comments of two other linguists who took part in translating the questionnaire. The interpretation process was done carefully to avoid any misinterpretation of accounting

[46] Refer to appendix 8
[47] Refer to appendix 10

and auditing terms. This research technique was utilised because the most dominant paradigm of the independence area is a quantitative approach with a survey method. In addition, semi-structured interviews have also been conducted with key users and auditors of financial statements. This is to enhance and complement the results obtained by the questionnaire survey. This questionnaire analysis is discussed in the following subsection.

4.5.1.2 Data Analysis

Diverse statistical techniques were employed for analysing the data collected by the questionnaire survey. Firstly, descriptive analysis for all the questions was addressed for the purpose of gaining a comprehensive picture of the issues related to auditor independence and perceived reliability of financial statements. Secondly, the t-test was employed at the total sample level to examine hypotheses: H_1 through to H_8. The t-test was also employed at the sub-group level to examine hypotheses H_{1a} through to H_{8a}. Thirdly, ANOVA and omega statistics were also employed to identify the most significant factors among all factors examined. Fourthly, factor analysis is employed to examine the interrelationship between the variables under investigation in this study. Fifthly, nonparametric tests were also employed to test hypotheses H_{1b} through to H_{8b}. These nonparametric tests include Wilcoxon Matched-Pairs Signed-Ranks tests and Friedman Two Way ANOVA.

4.5.1.2.1 Statistic Test (t-test)

The t-test is used for hypothesis testing a population mean for small samples and when the standard deviation of the population is unknown (Mann, 1995). Moreover, it has been argued by Levine et al., (1997) that there is, practically, a general consensus that since the sample size is not very small and the population is not very skewed, the t-test provides a good approximation to the sampling distribution of the mean. The current study aims to investigate the influence of eight main factors on the perceived audit independence on a five-point Likert scale, where 1 = "strongly undermines independence"; 2 = "undermines independence"; 3 = "has no effect on independence"; 4 = "enhances independence"; 5 = "strongly enhances independence". For this question, the t-test value is 3. Therefore, employing the one sample t-test would seem to be appropriate to examine hypotheses H_1 through to H_8 and H_{1a} through to H_{8a}.

4.5.1.2.2 Factor Analysis

One of the objectives this research study aims to achieve is to examine the relationships existing between the variables[48] that are perceived to have an influence on auditor independence. Factor analysis is used to identify and analyse the interrelationships among a large number of variables and to explain these variables in a small set of factors that represents the underlying relationships among a group of related variables. In order to examine this relationship, it was decided to determine whether these variables are suitable for factor analysis. Therefore, three conditions should be met to decide on the appropriateness of using factor analysis: (1) employing the Kaiser-Meyer-Olkin measure of sampling adequacy (MSA) provides a means to assess the suitability of using factor analysis. In this regard, the MSA value has to be above 0.60 (Pallant, 2007); (2) The Bartlett' Test of Sophericity should be significant at a level of 0.05 or smaller and (3) it has been argued by Hair et al. (1998) that smaller values of anti-image correlations are indicative of a data matrix which suits factor analysis (see appendix 7).

Once the previous measurements were conducted, it was found that the variables were appropriate for factor analysis[49]. In addition, factor extraction using principal component analysis (PCA) generated four factors with eigenvalues greater than one, explaining 67.57 percent of the total variance (see table 6.11 in chapter 6). In order to ease the interpretation, it is recommended that three components that explain 58.63 percent of the variances are extracted (Pallant, 2007). The same results can be obtained by performing the scree plot test, in which the graph tends to level off after the third eigenvalues (see appendix 6 scree plot graph). In this vien, it is recommended by Stevens (1992) that all eigenvalues in the sharp descent before the first eigenvalue on the line where they start to level off are maintained.

4.5.1.2.3 ANOVA and Omega Statistics

Omega statistics are a means of assessing the magnitude and significance of empirical results. It has been argued by Stout and Ruble (1995, p: 283) that "[the] *estimates of effect size provide information relevant to assessing the practical significance of research findings*". In addition, Olejnik and Algina (2003, p: 434) point out that to

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[48] Refer to Table 6.11 for more details

[49] The Kaiser-Meyer-Olkin Measure of Sampling Adequacy (MSA) value is 0.71 (more than 0.6) and The Bartlett' Test of Sophericity is 0.000 (less than 0.05).

enhancing research findings, researchers can include an effect-size measure along with a test of statistical significance. An effect-size measure is a standardised index and estimates a parameter that is independent of samples and quantifies the magnitude of the difference between explanatory and response variables. Therefore, Omega squared ω^2 is the statistical technique that is recommended for determining and measuring the magnitude (size effect) and the significance of research findings. In doing so, Omega statistics within the one way ANOVA context are performed[50].

4.5.2 The Interviews

The interviewing process is described by Miller (1991) as "the interview represents a personal contact between an interviewer and a respondent". Wright (1979) also states that interviews can be categorized into structured and unstructured interviews. As for the unstructured interviews, the interview takes the form of discussion procedure without a sequence of questions. In other words, the interview is flexible to the extent that the interviewer is able to cover different topics within the area of investigation. In this regard, Wright (1979) points out that "*unstructured interviewing tends to resemble conversation style with no set questions, following a broad outline of topics.*" In contrast, the structured interviews are conducted with sequence of questions in a strict instruction.

Interview is one of the data collection approaches in social science, which has advantages and disadvantage. They are: (1) Interviews usually yield a high percentage of returns; (2) personal interviews yield an almost perfect sample of the general population. This is because informants can individually be reached so that they respond to this instrument; (3) the information obtained is likely to be more accurate than that gathered using other techniques. This is because this technique is flexible to the extent that the interviewer is able to give explanation to questions that may be inaccurately answered; (4) the interviewer can collect supplementary information about informants' personal characteristics and environment. This additional information is valuable in interpreting and evaluating the validity of results of samples studied; (5) the interviewer is able to present visual material to which the respondent is to react; (6) the interviewer is able to correct mistakes or complete some items, by return visits. Therefore, a higher rate of usable returns is assumed than when other

[50] See chapter 6, section 6.11 for more details about ω statistics and the size effect measurement.

techniques are adopted; (7) the interviewer may catch the respondents unprepared and therefore secure more natural reactions than in the case of employing other approaches such as a mailed questionnaire; (8) the interviewer can control informants who answer the questions, whereas the mailed questionnaire might be answered by several members of household or respondents at targeted organisation(s); (9) a delicate situation can usually be handled more effectively in personal interviews than by other survey approaches; and (10) the language of the interviews is flexible so that it suits the ability and educational level of respondents Miler (1991)

However, there are some limitations of personal interviews. They are: (1) personal interviews entail high expenses and take long time. This make funding agencies hesitate to make grants for projects that mainly adopt personal interviews; (2) low response rates may occur due to changing in life-style in some areas in which crimes take place. This prevents interviewers from being able to conduct interviews within such areas; (3) interviews may supply inaccurate or incomplete information; (4) interviews that target informants at certain time and place, usually fail to gain the seeking rate; and (5) Interviewers may affect the informants response by the way they ask questions.

The interview survey conducted in the current study was to further explain the underlying meaning and connotation behind issues raised by the questionnaire survey. In this respect, (Robson, 2002) argues for the use of multiple methods of data collection, namely quantitative approach that may be enhanced by a qualitative one, so that both approaches enhance and complement one another. As discussed above using the multiple-approach, as in the current study, it provides a comprehensive understanding about the issues of auditor independence and the perceived reliability of audited financial statements. Thus semi-structured interviews were conducted with key subjects who responded to the questionnaire survey (see chapter 7 for more details). In this regard, it has been argued by Robson (1993) that interviews help gain new insights and obtain further explanation about issues that may be limited in the questionnaire survey approach. In order to achieve the research objectives, a standard interview guide was developed and used with all interviewees[51]. The questions used in the guide are similar to those used in the questionnaire survey. The main purpose

[51] Refer to Appendix 9

of this is to get further understanding and more insights about the same themes which were covered by the questionnaire survey. It should be noted that 12 themes were used in the interview guide, which are the same as those in the questionnaire survey.

The analysis of the interview data was conducted using procedures set out by Miles and Huberman (1994) and Yin (2003). This includes summarising, categorising and interpreting the qualitative data. Particularly, the interpretive analysis approach was used to analyse the interview data. In this vein, Patton (2002) argues that interpretation is about making inferences, developing insights, refining understandings and drawing conclusions. It should be noted that the total number of interviewees was 16 individuals comprising two owners, two investors, four lenders, three managers, and five auditors.

It can be argued that the use of mixed method to collect data gives high degree of reliability. In other words, the use of questionnaire and interviews in one study keeps the threats of errors or bias to a very minimum limit. Moreover, the participants of this study comprise of different groups of users and prepares of financial statements, this facilitates generalising the results across all the target population of this study. In addition, personally collected questionnaires gave the researcher the opportunity to check whether finished questionnaires were complete so that all questions were responded to, and this ensures a high response rate.

4.6 Summary

This chapter discussed both quantitative and qualitative approaches to research and highlighted a comparison between the two paradigms underlying both approaches. Positivism or the deductive approach uses quantitative methods that involve gathering and analysis of quantitative data using questionnaires and surveys. Phenomenological or the inductive approach refers to the qualitative methods that entails interviews that provide rich descriptive data. Since the use of one approach in isolation seem to make this approach vulnerable to weaknesses, therefore the use of methods, questionnaire survey and semi-structured interviews, is justified. This chapter is also devoted to describing the stages involved in the design and implementation of the research into perceived auditor independence and the perceived reliability of financial statements. This research includes the participation of five different populations; owner, investors, lenders, managers and auditors operating in Libya. This chapter also discusses the

development of a questionnaire survey which is complemented by semi-structured interviews. It also examines the statistical techniques utilised in this study to analyse the data. The following chapter explores the results obtained by the questionnaire survey.

Chapter 5

Questionnaire Results

5.1. Introduction

The findings of the questionnaire survey are described in this chapter. The data collected is analysed using the statistical package of the social sciences (SPSS). The sample of this study consists of 400 individuals, and includes commercial loan officers (lenders), investors and owners, managers and auditors. This chapter includes background about the respondents, general perceptions of auditor independence from the perspective of the user groups and the auditors who participate in this study. The chapter highlights the use and importance of audited financial statements. This chapter mainly reports the results of the effects of eight factors (examined in Chapter 3) on the perceived auditor independence of five groups of major users of financial statements. It is also devoted to describing the effects of these factors on the perceived reliability of audited financial statements.

5.2 Respondents' Profiles

Table 5.1 reveals that the sample of this research consists of five subgroups. These groups include commercial loan officers, individual investors and owners, managers, and external auditors. The response rate for the commercial loan officers (lenders), individual investors, owners, managers and auditors groups are 64 per cent, 53 per cent, 39 per cent, 40 per cent and 54 per cent respectively. As shown in table 5.1, this produces a total usable response rate of 50 per cent (N = 199). In terms of respondents' work experience, around 81 percent (N = 161) of respondents have from six to more than ten years of work experience. It can also be noted that 48 per cent of respondents are between 30 to 40 years of age, while only 13 percent of respondents are under 30 years old. The rest of the respondents' ages vary between 41 to over 50 years. It can also be seen from table 5.1 that around 53 per cent of respondents hold a university BSc degree. While only 12 per cent of respondents hold a PhD degree, the rest of the respondent groups hold a Masters Degree and high diploma, and undergraduate diploma in accounting.

Table 5.1: Respondents' Profiles

Group	Sample	Responses	%		
Lenders	80	51	64		
Investors	80	42	53		
Owners	80	31	39		
Managers	80	32	40		
Auditors	80	43	54		
	400	**199**	50		
Experience	**Less than 5yrs**	**6-10yrs**	**Over 10 yrs**	**Total**	
Lenders	4	7	40	51	
Investors	17	25	0	42	
Owners	0	29	2	31	
Managers	12	11	9	32	
Auditors	5	13	25	43	
	38	85	76	199	
Age	**Under 30 yrs**	**Between 30-40 yrs**	**Between 41-50 yrs**	**Over 50 yrs**	**Total**
Lenders	10	17	24	0	51
Investors	7	35	0	0	42
Owners	5	5	4	17	31
Managers	3	6	13	10	32
Auditors	0	33	7	3	43
	25	96	48	30	199

Qualification	CA	PhD	MSc	BSc	*Other	Total
Lenders	-	19	6	25	1	51
Investors	-	-	4	32	6	42
Owners	-	-	3	24	4	31
Managers	-	-	14	15	3	32
Auditors	24	4	5	10	0	43
	24	23	32	106	14	199

* High diploma in Accountancy & Diploma in Management and Accounting

5.2.1 Professional Training and Training Organisations

Table 5.2 reveals that around 60 per cent (N = 118) of respondents state that they have gained accounting and business-related training courses. However, over 40 per cent of respondents (N = 81) have stated that they have no professional accounting training. It can also be seen from table 5.2 that over 9 per cent (N = 11) of those who have gained professional training courses, were trained with one of the Big 4 audit firms. While over 86 per cent (N = 102) of those trained respondents have been trained with local government institutions. Moreover, only 4 per cent (N = 5) have been trained with local and private training and learning offices in Tripoli. It should

be noted that training experience varies across subgroups, for instance 100 per cent of the managers' group (N = 32) state that they gained accounting and business training.

Table 5.2: Professional Training and Training Organisations

Professional Training	**Yes**	**No**	**Total**	
Lenders	28	23	51	
Investors	34	8	42	
Owners	5	26	31	
Managers	32	0	32	
Auditors	19	24	43	
	118	81	199	
Training Organisation	**Big 4 auditors**	**Government training**	***Other**	**Total**
Lenders	0	27	1	28
Investors	0	32	2	34
Owners	0	5	0	5
Managers	0	31	1	32
Auditors	11	7	1	19
	11	102	5	118

* Private training and learning offices

5.3 General Perception of Auditor Independence

Table 5.3 reveals that over 58 per cent (N = 116) of respondents state that they have come across a lack of auditor independence. Whereas around 42 per cent (N = 83) of respondents indicate that they have not suspected a lack of independence. In order to determine whether this difference is significant, nonparametric tests are undertaken (Chi-square test). The results in table 5.3 show that the mean response is 1.42 and Standard deviation = 0.4943 at a significant level $P < 0.05$. Since the majority of respondents have experienced a lack of auditor independence, there might be reasons or factors which may result in such experience. The following sub-section (5.3.1) describes the effects of the eight factors (identified in chapter 3) on the perceptions of respondents as to whether these factors (reasons) may lead to suspicions of a lack of auditor independence. It should be noted that section (5.3 and its subsections) highlight the actual independence of auditors in Libya, whereas the rest of the chapter describes the perceived auditor independence.

5.3.1 Reasons Associated with Suspicions of a Lack of Auditor Independence

The previous section shows that 116 respondents have suspected a lack of auditor independence, while the total sample consists of 199 respondents. This produces a total number of 83 to whom this question is not applicable, which is described in table 5.4. Table 5.4 highlights the eight factors that may give rise to suspicions of a lack of auditor independence. It can be seen from the table that the higher response rate of 71 per cent (N = 83) is that when social relationships between auditors and their clients exist, respondents perceive that this reason leads to a lack of auditor independence. It can also be seen that over 64 per cent (N = 75) of responses indicate that a lack of legal incentives leads to the perceptions that auditors may lack professional independence. Moreover, table 5.4 shows that over 49 per cent (N = 57) of respondents state that when auditors are not rotated for more than 5 years, this leads to a lack of auditor independence. However, other reasons, such as "audit is performed by small audit office"; "no audit committee exists with audited entity"; "providing non-audit services"; "audit fees exceed 15 % of total audit revenue"; and "high audit competition" are perceived to be less important reasons that may result in a lack of auditor independence.

Table 5.3 : Previous Suspicions of a Lack of Auditor Independence

Previous suspicions of a lack of auditor independence %	**N**	
Yes	116	58.29
No	83	41.71
	199	100
Chi-Square Test Chi-Square = 5.4724; D.F = 1; P = 0.019 Mean = 1.42; Std.Deviation = 0.4943		

Although the majority of selected factors are perceived to be important reasons that lead to suspicions of a lack of independence, there are differences in the relative importance of these reasons. In order to determine whether these differences are important, non parametric tests were undertaken. The results, as shown in table 5.5, reveal that the most important factor that is perceived to be a key reason leading to a suspicion of a lack of independence is when social relationships exist between auditors and their clients, with a mean rank of 5.48. Table 5.5 also reveals that the

factor "audit fees, from one client, exceed 15 percent of total audit revenue" is perceived to be the least important reason among the other reasons. In other words, the lower the mean rank, the less important the factor in leading to suspicions of a lack of auditor independence. Moreover, the higher the mean rank the more important the reason that may lead to suspicions of a lack of auditor independence. It is worth noting that comparisons of reasons (a) & (e); (b) & (c); (b) & (d); (b) & (g); (c) & (d); (c) & (g); (d) & (g) (f) & (h) show no significant differences (at the P = 0.05 level) (see table 5.5).

Table 5.4: Reasons For Suspicions of a Lack of Auditor Independence

Reasons associated with suspicions of a lack of auditor independence :	N	%
(a) Audit is performed by small audit office		
No	84	72.41
Yes	32	27.59
	116*	100
(b) Auditor not rotated for more than 5 yrs		
No	59	50.86
Yes	57	49.14
	116*	100
(c) Audited company did not have audit committee		
No	65	56.03
Yes	51	43.97
	116*	100
(d) Audit firm provided non-audit services to the client		
No	61	52.59
Yes	55	47.41
	116*	100
(e) Audit fees from one client exceed 15 % of audit revenue		
No	85	73.28
Yes	31	26.72
	116*	100
(f) Lack of legal incentives to maintain independence		
No	41	35.34
Yes	75	64.66
	116*	100
(g) Audit is performed in high competitive audit environment		
No	63	54.31
Yes	53	45.69
	116*	100
(h) Social relationship between auditor and client exists		
No	33	28.45
Yes	83	71.55
	116*	100
*Total sample excluding 83 individuals to whom this question is not applicable.		

Table 5.5: Ranking of Reasons that Lead to Suspicions of a Lack of Independence

Friedman Two-Way ANOVA Test

Mean Rank	Reasons may lead to suspicions of a lack of AI
3.72	(a) Audit is performed by small audit office
4.58	(b) Auditor not rotated for more than 5 years
4.38	(c) Audited company does not have audit committee
4.51	(d) Audit firm provides non-audit services to the client
3.69	(e) Audit fees from one client exceed 15 % of total audit revenue
5.20	(f) Lack of legal incentives to maintain independence
4.44	(g) Audit is performed in high competitive audit environment
5.48	(h) Social relationship between auditor and client exists

Number of cases (NC) = 116; Chi-square = 77.0167; D.F= 7; P < 0.001

Wilcoxon Matched-Pairs Signed-Ranks Tests

	-Ranks		+Ranks		Ties	Test Results
	MR	NC	MR	NC	NC	
(a) & (b)	40.00	27	40.00	52	37	Z = - 2.813; P = 0.005*
(a) & (c)	32.00	22	32.00	41	53	Z = - 2.394; P = 0.017*
(a) & (d)	25.00	13	25.00	36	67	Z = - 3.286; P = 0.001*
(a) & (f)	40.00	18	40.00	61	37	Z = - 4.838; P = 0.000*
(a) & (g)	35.00	24	35.00	45	47	Z = - 2.528; P = 0.011*
(a) & (h)	39.00	13	39.00	64	39	Z = - 5.812; P = 0.000*
(b) & (e)	25.50	38	25.50	12	66	Z = - 3.677; P = 0.000*
(b) & (f)	21.50	12	21.50	30	74	Z = - 2.777; P = 0.005*
(b) & (h)	27.50	14	27.50	40	62	Z = - 3.538; P = 0.000*
(c) & (e)	28.50	38	28.50	18	60	Z = - 2.673; P = 0.008*
(c) & (f)	24.50	12	24.50	36	68	Z = - 3.464; P = 0.001*
(c) & (h)	31.50	15	31.50	47	54	Z = - 4.064; P = 0.000*
(d) & (e)	30.50	42	30.50	18	56	Z = - 3.098; P = 0.002*
(d) & (f)	37.50	27	37.50	47	42	Z = - 2.325; P = 0.020*
(d) & (h)	31.50	17	31.50	45	54	Z = - 3.556; P = 0.000*
(e) & (f)	33.50	11	33.50	55	50	Z = - 5.416; P = 0.000*
(e) & (g)	23.50	12	23.50	34	70	Z = - 3.244; P = 0.001*
(e) & (h)	28.50	2	28.50	54	60	Z = - 6.949; P = 0.000*
(f) & (g)	28.50	39	28.50	17	60	Z = - 2.940; P = 0.003*
(g) & (h)	27.50	12	27.50	42	62	Z = - 4.083; P = 0.000*

-Ranks First factor ranked more important reason leading to suspicions of a lack of auditor independence than the second factor
+Ranks First factor ranked less important reason leading to suspicions of a lack of auditor independence than the second factor
MR Mean rank is the sum of the ranks divided by the number of cases
* 2-Tailed Probability

5.4 Use, Importance and Reliability of Audited Financial Statements

Table 5.6 reveals the total of 199 excluding the external auditors group (which consists of 43 individuals) to whom this question is not applicable, produces 156 individuals who are required to respond to this question. Table 5.6 shows that over 30 per cent (N = 47) of these respondents state that they "always" use financial statements, for financial decision making. While more than 40 per cent (N = 66) of these respondents state that they "often" use audited financial statements for the financial decision making process. However, around 28 per cent (N = 43) of these respondents state that they "sometimes" use financial statements when making financial decisions. In terms of the importance attached to audited financial statements, table 5.6 shows that over 39 per cent (N = 62) of the respondents state that financial statements are "very important" or "important" for lending or investment decisions. It can also be noted that 44 per cent (N = 69) of the respondents state that financial statements are "moderately important" or "slightly important" for lending or investment decisions. However, only 16 per cent (N = 25) of the respondents state that financial statements are "unimportant" for lending or investment decisions.

Table 5.6: Use, Importance & Reliability of Audited Financial Statements

Using financial statements for decision making	**N**	**%**
Always	47	30.1
Often	66	42.3
Sometimes	43	27.6
Rarely	0	0.0
Never	0	0.0
	156	100
Importance of financial statements to lend/invest decisions		
Very important	15	9.6
Important	47	30.2
Moderately important	40	25.6
Slightly important	29	18.6
Unimportant	25	16.0
	156	100
Considering reliability & using financial statements for decision making		
Always	29	18.6
Often	94	60.3
Sometimes	33	21.1
Rarely	0	0.0
Never	0	0.0
	156	100

In terms of considering financial statements reliability, it can be seen from table 5.6 that over 18 per cent (N = 29) of the respondents who were required to respond to this question state that they "always" consider the reliability of audited financial statements when using them for the financial decision making process. Moreover, as shown in table 5.6, the higher percentage is that over 60 per cent (N = 94) of these respondents state that they "often" consider audited financial statements' reliability when using them for the process of financial decision making. However, a remaining 21 per cent (N = 33) of these respondents state that they "sometimes" consider reliability when using audited financial statements as an input for the financial decision making process. In this same context, the following sub-section describes the degree of importance of the auditing report which is attached to audited financial statements as perceived by all respondents in the sample of this study.

5.4.1 Auditor Independence and Financial Decision Making

Table 5.7 reveals that over 21 per cent (N = 33) of the respondents who are required to respond to this question state that they "always" consider auditor independence when making financial decisions. It can also be seen from table 5.7 that around 44 per cent (N = 68) of these respondents state that they "often" consider auditor independence during the process of financial decision making. However, over 35 per cent (N = 55) of these respondents state that they "sometimes" consider the independence of auditors when making their financial decisions including lending and / or investment decisions. Table 5.7 also shows that over 28 per cent of user groups (N = 45) state that, when the auditor is perceived to be not independent, they perceived that it had "no effect" on making their lending or investment decisions. It can also be seen from table 5.7 that a higher percentage which is over 53 per cent (N = 83) of these respondents to whom this question is applicable answered that they lend or invest less if the auditor is not independent. Moreover, over 17 per cent (N = 28) of these respondents state that they would not lend or invest at all.

5.4.2 Importance Attached to the Auditor's Report

Table 5.8 reveals that over half of respondents (N = 108) state that the auditor's report is "important", and a further 33 per cent (N = 66) of respondents perceived the auditor's

report to be "very important". While 3 per cent (N = 6) of respondents chose to indicate "undecided". However, over 9 per cent (N = 19) of respondents perceived that the auditor's report is "unimportant". To determine whether this difference is significant parametric tests were undertaken. A t-test indicated that the audit report is perceived to be important. Table 5.8 shows that the mean of sample responses = 1.89, Std Deviation = 0.857 at a significance level P < 0.001. Moreover, it should be noted that any value less than the test value 3 indicates the importance of the audit report while any value above 3 indicates the unimportance of the audit report. Number 1 indicates "very important" and 5 "not important at all", and the mean score is 1.89 which indicates "important" on the scale. Therefore, the auditor's report is important within the Libyan audit market as perceived by the participants of this research.

Table 5.7: Impact of Independent Audit on Financial Decision Making

Considering auditor independence when making financial decisions	**N**	**%**
Always	33	21.2
Often	68	43.5
Sometimes	55	35.3
Rarely	0	0.0
Never	0	0.0
	156*	100
Financial decision when auditor is perceived not independent	N	%
Lend/invest more	0	0
No effect	45	28.8
Lend/invest less	83	53.2
Would not lend/invest at all	28	18.0
*Total sample excluding auditors to whom this question is not applicable	156*	100

Table 5.8: Importance of Auditors' Report

Audit Report Importance				**N**	**%**
Very important				66	33.2
Important				108	54.3
Undecided				6	3.0
Not important				19	9.5
Not important at all				0	0.0
				199	**100**
Mean	**t**	**DF**	**Sig (2-tailed)**		
1.89	-18.2711	198	0.000		

5.5 Factors influencing the perceptions of auditor independence

The questionnaire survey results reveal that all eight factors examined are important and all affect the perceptions of auditor independence in the Libyan audit market. These factors are audit firm size, audit fee size, audit market competition, the provision of non-audit services, regulatory and legal incentives, audit committee existence within the audited entity, audit rotation and Libyan social relationships. The perceived effects of these factors are described at the total sample level as well as at each of the five subgroups who participated in the questionnaire survey. The five groups include owners, investors, lenders, managers and auditors. The following subsections are dedicated to providing detailed descriptions as to the effects of the above eight factors on the perceived auditor independence.

5.5.1 Audit Firm Size

It can be seen from Table 5.9, at the total sample level, that over 78 per cent of respondents (N = 157) perceive that when audit services are performed by one of the Big 4 audit firms, auditor's independence was enhanced and strongly enhanced. While 10 per cent of the respondents (N = 20) believe that when Big 4 audit firms supply audit services, it would have no effect on the independence of auditors. However, 11 per cent (N = 22) perceive that performing audit services by the Big 4 audit firms threatens auditor independence. More specifically, it undermines and strongly undermines auditor's independence. Table 5.9, at the subgroups level, shows that over 92 per cent (N = 29) of the owners' group perceive that the provision of audit services by the Big 4 audit firms enhances and strongly enhances the independence of auditors. However, only 2 respondents of the owners' group believe that the audit services of the Big 4 audit firms undermine and impair the auditor independence.

However, Table 5.9 shows that there is an opposite view which is reported by the investors' group. Over 37 per cent (N = 16) of the investors perceive that when the audit is performed by one of the Big 4 audit firms, the auditor independence is undermined and strongly undermined. A further 21 per cent (N = 9) of the investors think that a Big 4 audit firm has no effect on the independence. On the other hand, over 40 per cent (N = 17) of the investors' group perceive that when an audit service is performed by a Big 4

auditor, auditor independence is enhanced and strongly enhanced. Moreover, the lenders' group expressed more confidence in the audit services of the Big 4 auditors. In other words, as shown in table 5.9, over 95 per cent (N = 49) of lenders subgroup perceive that providing audit services by a Big 4 audit firm, enhances and strongly enhances auditor's independence. However, one lender thinks that the Big 4 audit firms have no effect on independence, and only one lender perceives that it strongly undermines independence.

The results suggest that the majority of the managers' group has strong confidence in the audit services provided by one of the Big 4 audit firms within the Libyan audit market. Table 5.9 indicates that over 93 per cent (N = 30) perceive that Big 4 audit firm services enhance and strongly enhance the independence of auditors. However, only two managers think that Big 4 audit firm services undermine independence. In addition, Table 5.9 also reveals that over 74 per cent (N = 32) of the auditors' subgroup, perceive that auditor independence is enhanced and strongly enhanced when audit services are performed by a Big 4 audit firm. A further 23 per cent (N = 10) of the auditors' group believe that Big 4 audit firms have no effect on the auditor independence. However, only one auditor perceives that performing audit services by a Big 4 audit firm, undermines auditor independence.

The results report that, at the total sample level, there is an increase in the perceptions of auditor independence, when the audit is provided by a large local audit office than when it is performed by a Big 4 audit firm. It can be noted that Libyan users seem to prefer large local audit offices than the Big 4 audit firms. Table 5.10 reveals that over 85 per cent (N = 171) of respondents perceived that audit services performed by a large local audit office enhances and strongly enhances auditor independence. Table 5.10 also shows that 6 per cent (N = 12) of respondents perceive that a large local audit office has no effect on auditor independence. However, 8 per cent (N = 16) of respondents perceive that audit services performed by a large local audit office undermines and strongly undermines independence. Table 5.10 also shows, at the owners' subgroup, that the owners' perceptions reflect higher credibility in the audit services of large local audit offices than of the Big 4 auditors. Table 5.10 also shows that over 40 per cent (N = 17)

of the investors' group, perceive that supplying audit services by a large local audit office, enhances and strongly enhances auditor independence.

Furthermore, 21 per cent (N = 9) of the investors' group think that the audit services provided by a large local audit office, have no effect on auditor independence. Nevertheless, 40 per cent (N = 16) of the investors' group responded that audit services by a large local audit office undermines and strongly undermines the independence of auditors. It can be seen from table 5.10 that the investors' group shows differing views when compared to the rest of the other groups. In addition, all lenders (N = 51) think that audit services of large local audit offices enhance and strongly enhance independence. While 90 per cent (N = 29) of the managers' group suggest that providing audit services by a large local audit office enhances and strongly enhances auditor independence. However, only 3 managers report that a large audit office's audit services have no effect on the independence. Moreover, Table 5.10 indicates that the whole auditors' group (N = 43) state that audit services provided by large audit offices, enhance and strongly enhance independence.

However, Table 5.11, at the total sample level shows a sharp drop in the level of the perceived auditor independence, when the audit is performed by smaller audit offices. It reveals that 85 per cent (N = 169) of respondents perceive that when audit services were performed by small audit offices, auditor independence is undermined and strongly undermined. A further 14 per cent (N = 29) of respondents perceive that a small audit office has no effect on auditor independence. However, only one respondent suggests that a small audit office enhances auditor independence. Moreover, as shown from Table 5.11 at the subgroups level, all of the owners' group perceive that when a small audit office provides audit services, the auditor independence is undermined and strongly undermined. In addition, 97 per cent (N = 41) of the investors group believe that when an audit service is performed by a small audit office, independence is undermined and strongly undermined, while only one investor perceives that a small audit office has no effect on the independence.

In addition, Table 5.11 shows that 58 per cent (N = 30) of the lenders' group state that the independence of a small auditor is undermined and strongly undermined. A further 39

per cent (N = 20) of the lenders' group suggest that a small audit office has no effect on the auditor independence. However, only one lender believes that audit services by a small audit office enhances auditor independence. Moreover, over 90 per cent (N = 29) of the managers' group report that auditor independence is undermined and strongly undermined when audit services are by small auditors, while only 3 managers suggest that the audit services by small audit offices have no effect on auditor independence. Furthermore, Table 5.11 reveals that over 88 per cent (N = 38) of the auditors' group believe that the audit services of small audit offices undermine and strongly undermine the independence of auditors. However, only 5 auditors perceive that small audit offices have no effect on independence.

Table 5.9: The Impact of Audit Firm Size, audit is performed by Big 4 audit firm

BIG4	Total Sample		Owners		Investors		Lenders		Managers		Auditors	
*LOP	N	%	N	%	N	%	N	%	N	%	N	%
1	16	8.0	0	0.0	15	35.7	1	2.0	0	0.0	0	0.0
2	6	3.0	2	6.5	1	2.4	0	0.0	2	6.3	1	2.3
3	20	10.1	0	0.0	9	21.4	1	2.0	0	0.0	10	23.3
4	123	61.8	21	67.7	15	35.7	31	60.8	27	84.4	29	67.4
5	34	17.1	8	25.8	2	4.8	18	35.3	3	9.4	3	7.0
Total	**199**	**100.00**	**31**	**100.0**	**42**	**100.0**	**51**	**100.0**	**32**	**100.0**	**43**	**100.0**

*LOP = Level of Perception; 1 = Strongly Undermines Independence, 2 = Undermines Independence, 3 = No Effect on Independence, 4 = Enhances Independence, 5 = Strongly Enhances Independence.

Table 5.10: The Impact of Audit Firm Size, audit is performed by large audit office

LRGOFC	Total Sample		Owners		Investors		Lenders		Managers		Auditors	
*LOP	N	%	N	%	N	%	N	%	N	%	N	%
1	11	5.5	0	0.0	11	26.2	0	0.0	0	0.0	0	0.0
2	5	2.5	0	0.0	5	11.9	0	0.0	0	0.0	0	0.0
3	12	6.0	0	0.0	9	21.4	0	0.0	3	9.4	0	0.0
4	77	38.7	8	25.8	10	23.8	26	51.0	7	21.9	26	60.5
5	94	47.2	23	74.2	7	16.7	25	49.0	22	68.8	17	39.5
Total	**199**	**100.00**	**31**	**100.0**	**42**	**100.0**	**51**	**100.0**	**32**	**100.0**	**43**	**100.0**

*LOP = Level of Perception; 1 = Strongly Undermines Independence, 2 = Undermines Independence, 3 = No Effect on Independence, 4 = Enhances Independence, 5 = Strongly Enhances Independence.

Table 5.11: The Impact of Audit Firm Size, audit is performed by small audit office

SMLOFC	Total Sample		Owners		Investors		Lenders		Managers		Auditors	
*LOP	N	%	N	%	N	%	N	%	N	%	N	%
1	67	33.7	26	83.9	17	40.5	4	7.8	9	28.1	11	25.6
2	102	51.3	5	16.1	24	57.1	26	51.0	20	62.5	27	62.8
3	29	14.6	0	0.0	1	2.4	20	39.2	3	9.4	5	11.6
4	1	0.5	0	0.0	0	0.0	1	2.0	0	0.0	0	0.0
5	0	0.0	0	0.0	0	0.0	0	0.0	0	0.0	0	0.0
Total	**199**	**100.00**	**31**	**100.0**	**42**	**100.0**	**51**	**100.0**	**32**	**100.0**	**43**	**100.0**

*LOP = Level of Perception; 1 = Strongly Undermines Independence, 2 = Undermines Independence, 3 = No Effect on Independence, 4 = Enhances Independence, 5 = Strongly Enhances Independence.

5.5.2 Audit Fee Size

Table 5.12 shows, at the total sample level, that over 49 per cent (N = 99) of respondents perceive that high audit fees, when one-client audit fee exceeds 15 per cent of the total audit revenue, undermine and strongly undermine independence. However, over 48 per cent (N = 97) of respondents believe that the 15 per cent of audit fee category has no effect on auditor independence. In addition, only 3 respondents suggest that high audit fees (one-client audit fee is above 15 per cent of total audit gross) strongly enhance auditor independence. At the subgroups level, Table 5.12 shows that 84 per cent (N = 26) of the owners' group perceive that when one-client audit fees exceed 15 percent of total audit services, the income auditor independence is undermined. However, only 5 owners suggest that this (15 percent audit fee category) has no effect on the independence.

Table 5.12 also reveals that over 73 per cent (N = 31) of the investors' group believe that when one-client audit fees exceed 15 per cent of the total audit fees, auditor independence is undermined and strongly undermined. While 26 per cent (N = 11) of the investors' group think that an audit fee, received from one client, exceeding 15 per cent of total audit returns, has no effect on auditor independence. However, the lenders' group expressed a different view, as shown in Table 5.12: 31 per cent (N = 16) of the lenders' group suggest that, when one-client audit fee is more than 15 per cent, in comparison to the total audit gross, auditor independence is undermined and strongly undermined. However, over 62 per cent (N = 32) of the lenders' group think that the 15 percent audit fee level has no effect on auditor independence. Furthermore, only 3 lenders perceive that the excess of 15 percent audit fee level strongly enhances auditor independence.

Table 5.12 also reveals that over 59 per cent (N = 19) of the managers' group perceive that the audit fees level which exceeds 15 per cent of the total audit revenue, undermines and strongly undermines independence of auditors. While 40 per cent (N = 13) of the mangers' group think that the 15 per cent audit fee level has no effect on the auditor independence. However, the auditors' group shows a different perspective regarding the effect of the excess of 15 per cent audit fee level.

Table 5.12: The Impact of Audit Fee Size, one-client audit fee exceeds 15 % of total audit revenue

FEE	Total Sample		Owners		Investors		Lenders		Managers		Auditors	
*LOP	N	%	N	%	N	%	N	%	N	%	N	%
1	19	9.5	0	0.0	11	26.2	3	5.9	2	6.3	3	7.0
2	80	40.2	26	83.9	20	47.6	13	25.5	17	53.1	4	9.3
3	97	48.7	5	16.1	11	26.2	32	62.7	13	40.6	36	83.7
4	0	0.0	0	0.0	0	0.0	0	0.0	0	0.0	0	0.0
5	3	1.5	0	0.0	0	0.0	3	5.9	0	0.0	0	0.0
Total	**199**	**100.00**	**31**	**100.0**	**42**	**100.0**	**51**	**100.0**	**32**	**100.0**	**43**	**100.0**

*LOP = Level of Perception; 1 = Strongly Undermines Independence, 2 = Undermines Independence, 3 = No Effect on Independence, 4 = Enhances Independence, 5 = Strongly Enhances Independence.

As shown in Table 5.12, only 16 per cent (N = 7) of the auditors' group perceive that when the audit fee received from a client is more than 15 per cent of the total audit revenue, auditor independence is impaired and strongly impaired. However, over 83 per cent (N = 36) of the auditors' group believe that this level of audit fee has no effect on auditor independence.

5.5.3 Audit Market Competition

The effects of audit market competition are shown in Table 5.13. At the total sample level, Table 5.13 reveals that over 78 per cent (N = 156) of the respondents perceive that performing audit services within a high competitive audit market undermines and strongly undermines auditor independence. While 10 per cent (N = 20) of respondents think that a highly competitive audit market has no effect on auditor independence. However, 11 per cent (N = 23) of respondents think that a highly competitive audit market enhances and strongly enhances the independence of auditors. Furthermore, at the subgroups level, Table 5.13 shows that all of the owners' group believe that competition is a threat to the independent audit. Table 5.13 also shows that over 37 per cent (N = 19) of the lenders' group believe that a highly competitive audit market undermines and strongly undermines auditor independence. While 25 per cent (N = 13) of the lenders' group suggest that a highly competitive audit market has no effect on auditor independence. However, 37 per cent (N = 19) of the lenders' group report that a highly competitive audit market enhances and strongly enhances auditor independence.

Table 5.13 also shows, at the subgroups level, over 80 per cent (N = 26) of the managers' group perceive that a highly competitive audit market undermines and strongly undermines auditor independence. However, only 6 managers think that audit services within a highly competitive audit market have no effect on auditor independence. In addition, Table 5.13 reveals that all of the auditors' group (N = 43) suggest that a highly competitive audit market undermines and strongly undermines auditor independence.

Table 5.13: The Impact of Competition, audit services performed in high competitive audit market

COPMET	Total Sample		Owners		Investors		Lenders		Managers		Auditors	
*LOP	N	%	N	%	N	%	N	%	N	%	N	%
1	53	26.6	0	0.0	17	40.5	8	15.7	5	15.6	23	53.5
2	103	51.8	31	100.0	20	47.6	11	21.6	21	65.6	20	46.5
3	20	10.1	0	0.0	1	2.4	13	25.5	6	18.8	0	0.0
4	14	7.0	0	0.0	4	9.5	10	19.6	0	0.0	0	0.0
5	9	4.5	0	0.0	0	0.0	9	17.6	0	0.0	0	0.0
Total	**199**	**100.00**	**31**	**100.0**	**42**	**100.0**	**51**	**100.0**	**32**	**100.0**	**43**	**100.0**

*LOP = Level of Perception; 1 = Strongly Undermines Independence, 2 = Undermines Independence, 3 = No Effect on Independence, 4 = Enhances Independence, 5 = Strongly Enhances Independence.

5.5.4 Non-Audit Service Provision

The effects of providing non-audit services to the audit clients are presented in Table 5.14. As shown from Table 5.14, at the total sample level, over 81 per cent (N = 162) of respondents think that providing non-audit services along with audit services to audit clients undermines and strongly undermines auditor independence. A further 16 per cent (N = 33) of respondents suggest that non-audit services to audit clients has no effect on auditor independence. However, only 4 respondents perceive that non-audit services provision enhances and strongly enhances auditor independence. In addition, all of the owners' group (N = 31) and 64 percent (N = 27) of the investors' group believe that non-audit services threaten auditor independence, while 35 per cent (N = 15) of the investors' group perceive that non-audit services have no effect on independence. Furthermore, 76 per cent of the lenders' group believe that non-audit services to audit clients impairs independence. While 15 per cent (N = 8) of the lenders' group suggest that non-audit services has no impact on the independence. However, only 4 lenders believe that non-audit services to audit clients enhances auditor independence

Table 5.14 also reveals that over 96 per cent of the managers' group suggests that the provision of non-audit services to audit clients undermines and strongly undermines independence. However, only one manager perceives that providing non-audit services to audit clients has no influence on auditor independence. Besides, 79 per cent (N = 34) of the auditors' group view that non-audit services to audit clients impairs independence. However, as shown from Table 5.14, over 20 per cent (N = 9) of the auditors' group perceive that there is no impact on auditor independence by the provision of non-audit service to audit clients.

In addition, the effects of the non-audit services to non-audit clients are described in Table 5.15. As seen from table 5.15, the majority of respondents, over 80 per cent (N = 160), perceive that non-audit services to non-audit clients has no effect on auditor independence. A further 8 per cent (N = 16) of the respondents believe that non-audit services to non-audit clients undermines independence. However, over 11 per cent (N = 23) of respondents perceive that providing non-audit services to non-audit clients enhances auditor independence. Table 5.15 also reveals that over 67 per cent (N = 21) of the owners' group believe that non-audit services to non-audit clients has no impact on the independence. While 22 per cent (N = 7) of the owners' group think that non-audit services to non-audit clients undermines auditor independence.

Table 5.14 : The Impact of Non-Audit Services Provision to Audit Clients

NAS	Total Sample		Owners		Investors		Lenders		Managers		Auditors	
*LOP	N	%	N	%	N	%	N	%	N	%	N	%
1	50	25.1	26	83.9	10	23.8	1	2.0	10	31.3	3	7.0
2	112	56.3	5	16.1	17	40.5	38	74.5	21	65.6	31	72.1
3	33	16.6	0	0.0	15	35.7	8	15.7	1	3.1	9	20.9
4	1	0.5	0	0.0	0	0.0	1	2.0	0	0.0	0	0.0
5	3	1.5	0	0.0	0	0.0	3	5.9	0	0.0	0	0.0
Total	**199**	**100.00**	**31**	**100.0**	**42**	**100.0**	**51**	**100.0**	**32**	**100.0**	**43**	**100.0**

*LOP = Level of Perception; 1 = Strongly Undermines Independence, 2 = Undermines Independence, 3 = No Effect on Independence, 4 = Enhances Independence, 5 = Strongly Enhances Independence.

Table 5.15: The Impact of Non-audit Services Provision to Non-audit Clients

NASNC	Total Sample		Owners		Investors		Lenders		Managers		Auditors	
*LOP	N	%	N	%	N	%	N	%	N	%	N	%
1	0	0.0	0	0.0	0	0.0	0	0.0	0	0.0	0	0.0
2	16	8.0	7	22.6	5	11.9	1	2.0	0	0.0	3	7.0
3	160	80.4	21	67.7	36	85.7	41	80.4	28	87.5	34	79.1
4	23	11.6	3	9.7	1	2.4	9	17.6	4	12.5	6	14.0
5	0	0.0	0	0.0	0	0.0	0	0.0	0	0.0	0	0.0
Total	**199**	**100.00**	**31**	**100.0**	**42**	**100.0**	**51**	**100.0**	**32**	**100.0**	**43**	**100.0**

*LOP = Level of Perception; 1 = Strongly Undermines Independence, 2 = Undermines Independence, 3 = No Effect on Independence, 4 = Enhances Independence, 5 = Strongly Enhances Independence.

However, only 3 owners suggest that non-audit services to non-audit clients enhance independence.

Table 5.15 also shows that over 85 per cent (N = 36) of the investors' group think that providing non-audit services to non-audit clients has no effect on auditor independence. Furthermore, over 11 per cent of the investors' group believes that non-audit services to non-audit clients undermines independence. However, only one investor perceives that it enhances auditor independence. Table 5.15 also shows that the majority of the lenders' group, over 80 per cent (N = 41) report that non-audit services to non-audit clients has no effect on the auditor independence. Furthermore, 17 per cent (N = 9) of the lenders' group suggest that it enhances auditor independence. However, only one lender thinks it undermines auditor independence. In addition, over 87 per cent (N = 34) of the managers' group believe that providing non-audit services to non-audit clients has no impact on auditor independence. However, only 4 managers perceive that it enhances auditor independence. Table 5.15 also shows that 79 per cent (N = 34) of the auditors' group suggest that the provision of non-audit services to non-audit clients has no effect on auditor independence, while only 3 auditors indicate that it undermines auditor independence. However, 6 auditors think that non-audit services to non-audit clients enhance the independence of auditors.

5.5.5 Legal and Institutional Incentives

Table 5.16 reveals that the majority (over 95 per cent) (N = 190), of respondents believe that the audit market that lacks legal incentives undermines and strongly undermines auditor independence. While 8 respondents think that a lack of legal incentives within the audit market has no impact on auditor independence. However, only one respondent reports that a lack of legal incentives enhances auditor independence. Table 5.16 also shows that owners, investors and auditors subgroups share a similar perspective. These three groups suggest that the audit market which lacks legal incentives undermines and strongly undermines auditor independence. This view is shared by 88 per cent of the lenders and by 90 per cent of the managers. It can be noted that only 5 lenders and 3 managers share the same opinion that a lack of legal incentives has no impact on auditor independence. However, only one lender suggests that it enhances auditor independence. Table 5.17 shows the effect of the unavailability of domestic independence standards.

Table 5.16: The Impact of Legal Incentives, audit market lacks legal incentives

LEGAL	Total Sample		Owners		Investors		Lenders		Managers		Auditors	
*LOP	N	%	N	%	N	%	N	%	N	%	N	%
1	110	55.3	19	61.3	26	61.9	22	43.1	18	56.3	25	58.1
2	80	40.2	12	38.7	16	38.1	23	45.1	11	34.4	18	41.9
3	8	4.0	0	0.0	0	0.0	5	9.8	3	9.4	0	0.0
4	1	0.5	0	0.0	0	0.0	1	2.0	0	0.0	0	0.0
5	0	0.0	0	0.0	0	0.0	0	0.0	0	0.0	0	0.0
Total	**199**	**100.00**	**31**	**100.0**	**42**	**100.0**	**51**	**100.0**	**32**	**100.0**	**43**	**100.0**

*LOP = Level of Perception; 1 = Strongly Undermines Independence, 2 = Undermines Independence, 3 = No Effect on Independence, 4 = Enhances Independence, 5 = Strongly Enhances Independence.

Table 5.17: The Impact of unavailability of Domestic Independence Standards

LDISTD	Total Sample		Owners		Investors		Lenders		Managers		Auditors	
*LOP	N	%	N	%	N	%	N	%	N	%	N	%
1	84	42.2	0	0.0	29	69.05	23	45.10	17	53.1	15	34.9
2	80	40.2	5	16.1	13	30.95	21	41.18	13	40.6	28	65.1
3	35	17.6	26	83.9	0	0.00	7	13.73	2	6.3	0	0.0
4	0	0.0	0	0.0	0	0.00	0	0.00	0	0.0	0	0.0
5	0	0.0	0	0.0	0	0.00	0	0.00	0	0.0	0	0.0
Total	**199**	**100.00**	**31**	**100.0**	**42**	**100.0**	**51**	**100.0**	**32**	**100.0**	**43**	**100.0**

*LOP = Level of Perception; 1 = Strongly Undermines Independence, 2 = Undermines Independence, 3 = No Effect on Independence, 4 = Enhances Independence, 5 = Strongly Enhances Independence.

This study is concerned with the Libyan audit market and its lack of national or local independence standards. It can be seen from Table 5.17 that the majority, over 82 per cent (N = 164), of respondents perceive that the audit market lacks domestic independence standards and undermines and strongly undermines auditor independence. However, only 17 per cent (N = 35) of respondents suggest that the unavailability of national independence standards has no impact on auditor independence. Table 5.17 also reveals that the investors, lenders, managers and auditors share a similar view: that the lack of Libyan independence standards threatens auditor independence. However, the contrary perspective is expressed by the majority, 84 per cent (N = 26) of the owners' group who reports that there is no effect on independence when the audit market lacks domestic independence standards.

5.5.6 Audit Committee

The effects of the audit committee's existence in the client's company on auditor independence are presented in Table 5.18. It can be seen from Table 5.18 that over 64 per cent (N = 128) of respondents perceive that the existence of audit committees in the audited entity enhances and strongly enhances auditor independence. While 27 per cent (N = 53) believe that an audit committee's existence has no effect on the independence of auditors. However, 9 per cent (N = 18) of respondents report a contradictory view which is that an audit committee's existence undermines and strongly undermines auditor independence. At the subgroups level, Table 5.18 indicates that the lenders, managers and auditors are representing parallel views as they suggest that the audit committee's existence supports the external independent audit. However, a conflicting perception is reported by the majority, 74 per cent (N = 23), of the owners who suggest that an audit committee has no benefit to the independent audit. In addition, a low percentage of 35 per cent (N = 15) of the investors' group perceive that an audit committee enhances and strongly enhances auditor independence. While 26 per cent of the investors' group report that an audit committee has no effect on independence. However, another view is reported by 38 per cent (N = 16) of the investors' group who believe that an audit committee's existence within the audited entity undermines and strongly undermines independence.

Table 5.18: The Impact of Audit Committee Existence

AC	Total Sample		Owners		Investors		Lenders		Managers		Auditors	
*LOP	N	%	N	%	N	%	N	%	N	%	N	%
1	8	4.0	0	0.0	7	16.7	1	2.0	0	0.0	0	0.0
2	10	5.0	0	0.0	9	21.4	1	2.0	0	0.0	0	0.0
3	53	26.6	23	74.2	11	26.2	11	21.6	5	15.6	3	7.0
4	99	49.7	8	25.8	14	33.3	31	60.8	10	31.3	36	83.7
5	29	14.6	0	0.0	1	2.4	7	13.7	17	53.1	4	9.3
Total	**199**	**100.00**	**31**	**100.0**	**42**	**100.0**	**51**	**100.0**	**32**	**100.0**	**43**	**100.0**

*LOP = Level of Perception; 1 = Strongly Undermines Independence, 2 = Undermines Independence, 3 = No Effect on Independence, 4 = Enhances Independence, 5 = Strongly Enhances Independence.

5.5.7 Audit Rotation

Table 5.19 portrays the impact of audit rotation on perceived auditor independence. The effect of audit rotation is described at the total sample level as well as at each subgroup level. It can be revealed from Table 5.19 that the majority, 83 per cent (N = 165), of respondents suggest that rotating auditors every 5 years enhances and strongly enhances their independence. At the subgroups level, the owners, lenders, managers, and auditors represent the same view which suggests that a five-year auditor rotation protects and enhances auditor independence. However, the investors' group highlights diverse responses which can be divided into three views. Firstly, 50 per cent (N = 21) of the investors suggest that rotating auditors every five years protects and enhances the independence of the auditors. Secondly, 12 per cent (N = 5) of the investors' group report that the five-year auditor rotation has no impact on auditor independence. Thirdly, 38 per cent (N = 16) of the investors' group believe that the auditor's rotation every five years undermines and strongly undermines auditor independence.

5.5.8 Libyan Social Relationships

The effect of social relationships, within the Libyan society, on the auditor independence is presented in Table 5.20. Table 5.20 reveals that the majority, 89 per cent (N = 177) of the respondents suggest that social relationships within the Libyan community undermine and strongly undermine the independence of auditors who are members of Libyan society. However, only 11 per cent (N = 22) of respondents perceive that social relationships have no effect on the independence of the Libyan auditors. Table 5.20 also shows that, at the subgroups level, the majority of lenders, all managers, and all auditors express similar perceptions regarding the effect of Libyan social relationships, which suggests that Libyan social relationships threaten and impair the independence of the Libyan auditors. A further 61 per cent (N = 19) of the owners' group believe that Libyan social relationships threaten and undermine the independence of the Libyan auditors. However, over 38 per cent (N = 12) of the owners' group perceive that Libyan social relationships have no impact on the independence of the auditors.

Table 5.19: The Impact of Audit Rotation, rotating auditors every 5 years

ROTATE	Total Sample		Owners		Investors		Lenders		Managers		Auditors	
*LOP	N	%	N	%	N	%	N	%	N	%	N	%
1	10	5.0	0	0.0	10	23.8	0	0.0	0	0.0	0	0.0
2	6	3.0	0	0.0	6	14.3	0	0.0	0	0.0	0	0.0
3	18	9.0	0	0.0	5	11.9	11	21.6	2	6.3	0	0.0
4	116	58.3	24	77.4	15	35.7	20	39.2	20	62.5	37	86.0
5	49	24.6	7	22.6	6	14.3	20	39.2	10	31.3	6	14.0
Total	**199**	**100.00**	**31**	**100.0**	**42**	**100.0**	**51**	**100.0**	**32**	**100.0**	**43**	**100.0**

*LOP = Level of Perception; 1 = Strongly Undermines Independence, 2 = Undermines Independence, 3 = No Effect on Independence, 4 = Enhances Independence, 5 = Strongly Enhances Independence.

Table 5.20: The Impact of Libyan Social Relationships

SOCIAL	Total Sample		Owners		Investors		Lenders		Managers		Auditors	
*LOP	N	%	N	%	N	%	N	%	N	%	N	%
1	34	17.1	0	0.0	9	21.4	20	39.2	0	0.0	5	11.6
2	143	71.9	19	61.3	28	66.7	26	51.0	32	100.0	38	88.4
3	22	11.1	12	38.7	5	11.9	5	9.8	0	0.0	0	0.0
4	0	0.0	0	0.0	0	0.0	0	0.0	0	0.0	0	0.0
5	0	0.0	0	0.0	0	0.0	0	0.0	0	0.0	0	0.0
Total	**199**	**100.00**	**31**	**100.0**	**42**	**100.0**	**51**	**100.0**	**32**	**100.0**	**43**	**100.0**

*LOP = Level of Perception; 1 = Strongly Undermines Independence, 2 = Undermines Independence, 3 = No Effect on Independence. 4 = Enhances Independence. 5 = Strongly Enhances Independence.

5.6 Perceptions of Reliability of Audited Financial Statements

It should be noted that the previous section is devoted to describing the effects of the selected variables on the perceptions of auditors' independence from the perspective of five major groups. It was assigned to highlight the main results of this study at two levels: the total sample level and the subgroups level. The subsequent subsections are devoted to describing the effects of these variables (which are addressed in chapter three) on the perceptions of the reliability of audited financial statements (RAFS hereafter). The influence of these factors on the perceptions of the reliability of financial statements are based on whether or not the auditor is independent.

5.6.1 Perceived Auditor Independence and the RAFS

It can be noted from table 5.21 that the auditors' group of 43 individuals to whom this question is not applicable, produces a total user group of 156 individuals who are required to respond to this question. Table 5.21 also shows that over 15 per cent (N = 24) of these respondents state that they "always" consider the auditor's independence when assessing the reliability of audited financial statements. It can also be seen from table 5.21 that over 50 per cent (N = 79) of these respondents state that they "often" consider the auditor's independence when they assess the reliability of audited financial statements. Moreover, 34 per cent (N = 53) of these respondents state that they "sometimes" consider the auditor's independence when assessing the reliability of audited financial statements.

It can also be seen from table 5.21 that over 21 per cent (N = 34) of these respondents state that, when an auditor is not independent, their level of confidence of the reliability of audited financial statements "decreases significantly". In addition, table 5.21 show that around 55 per cent (N = 85) of the respondents to whom this question is applicable respond that while the auditor is perceived not to be independent, their level of confidence of the reliability of audited financial statements "decreases to some extent". However, there are over 23 per cent (N = 37) of these respondents with the view that a lack of independence has "no effect" on their level of confidence of the reliability of the audited financial statements

Table 5.21: Auditor Independence Impact on RAFS

Considering AI when assessing RAFS	N	%
Always	24	15.4
Often	79	50.6
Sometimes	53	34.0
Rarely	0	0.0
Never	0	0.0
	156	100
Level of confidence in RAFS while auditor is not independent	**N**	**%**
Decreases confidence significantly	34	21.8
Decreases confidence to some extent	85	54.5
No effect on confidence	37	23.7
	156	100

5.6.2 Audit Firm Size and the RAFS

Table 5.22 reveals that the majority of respondents, over 87 per cent (N = 176) perceive the financial statements to be "always" or "often" reliable when audited by one of the Big 4 audit firms. However, 11 per cent N = 23) of respondents state that financial statements audited by the Big 4 audit firms are "sometimes" reliable. Furthermore, it can also be seen from table 5.22 that there is an increase in the perceived reliability of financial statements when audited by a large audit office. Table 5.22 shows that over 96 per cent (N = 193) of respondents perceive that financial statements audited by a local large audit firm are "always" or "often" reliable. In addition, only 3 per cent of respondents perceive that financial statements are sometimes reliable when audited by a large audit office (see table 5.22).

Table 5.22: Impact of Audit Firm Size on the RAFS

Financial statements are perceived to be reliable when the audit is performed by:	N	%
Big 4 audit firm.		
Always	63	31.7
Often	113	56.8
Sometimes	23	11.5
Rarely	0	0.0
Never	0	0.0
	199	100.0
Large audit office.		
Always	117	58.8
Often	76	38.2
Sometimes	6	3.0
Rarely	0	0.0
Never	0	0.0
	199	100.0

5.6.3 Audit Fees Size and the RAFS

The subsequent table describes the effect of audit fee size on the perceived reliability of financial statements. Table 5.23 reveals that over 28 per cent (N = 56) of respondents perceive financial statements to be "always" or "often" reliable when audit fees from one client exceeds 15 per cent of the total audit revenue. It can be noted that a higher percentage, over 41 per cent (N = 82) perceive financial statements to be "sometimes" reliable when audit fees from one client exceed 15 per cent of the total audit revenue. However, a further 13 per cent (N = 26) perceive financial statements to be "rarely" reliable when audit fees from one client exceed 15 per cent of the total audit revenue. Furthermore, over 17 per cent (N = 35) of respondents perceive financial statements to be "never" reliable when audit fees from one client exceed 15 per cent of the total audit revenue.

It can also be noted from table 5.23 that there is an impressive increase in the perceived level of reliability of financial statements when an audit fee from one client is less then 15 per cent of the total audit revenue. Table 5.23 reveals that almost the majority of respondents (over 79 percent, N = 158) perceive audited financial statements to be "always" or "often" reliable when an audit fee from one client does not exceed 15 per cent of the total audit revenue. Further 20 per cent (N = 40) of respondents perceive financial statements to be "sometimes" reliable. However, only one respondent perceives financial statements to be "rarely" reliable.

Table 5.23: The Impact of Audit Fees on RAFS

Reliability of financial statements when one-client audit fee	N	%
Does exceed 15 % of total audit revenue		
Always	14	7.0
Often	42	21.1
Sometimes	82	41.2
Rarely	26	13.1
Never	35	17.6
	199	100
Does not exceed 15 % of total audit revenue		
Always	42	21.1
Often	116	58.3
Sometimes	40	20.1
Rarely	1	0.5
Never	0	0.0
	199	100

5.6.4 Audit Competition and the RAFS

The effect of competition is described in table 5.24. The table reveals that over 65 per cent (N = 130) of respondents perceive financial statements to be "always" or "often" reliable when audited within a highly competitive audit market. A further 17 per cent (N = 33) perceive financial statements to be "sometimes" reliable when they are audited in a highly competitive audit market. However, 18 per cent (N = 36) of respondents perceive financial statements to be "rarely" reliable when audited in such an audit market. Nonetheless, it can also be noted from table 5.24 that there is a dramatic increase in the level of perceived reliability of financial statements when they are audited in a market with low competition.

It can be seen from table 5.24 that 89 per cent (N = 178) of respondents perceive audited financial statements to be "always" or "often" reliable when audit competition is low. Moreover, 7 per cent (N = 14) of respondents perceive audited financial statements to be "sometimes" reliable when audit competition is low. However, there are 7 respondents who perceive audited financial statements to be "rarely" reliable when audit competition is low. It can be noted that the majority of respondents perceive financial statements to be more reliable in low competition than those audited in a highly competitive audit market.

Table 5.24: The Impact of Competition on RAFS

RAFS when audit is performed	N	%
(a) within high competitive audit market		
Always	44	22.1
Often	86	43.2
Sometimes	33	16.6
Rarely	36	18.1
Never	0	0.0
	199	100.0
(b) within low audit competition		
Always	53	26.6
Often	125	63.0
Sometime	14	7.0
Rarely	7	3.5
Never	0	0.0
	199	100.0

5.6.5 Non-Audit Service and the RAFS

The effect of non-audit services on the audited financial statements reliability is described using four different situations. In the first situation (a), it can be seen from table 5.25 that over 65 per cent (N = 131) of respondents perceive financial statements to be "always" or "often" reliable when non-audit services are provided to audit clients by personnel involved in the audit. A further 20 per cent (N = 40) perceive them to be "sometimes" reliable. However, over 13 per cent (N = 28) of respondents perceive financial statements to be "rarely" or "never" reliable when non-audit services are provided to audit clients by auditors involved in the audit. It can also be noted from table 5.25 that there is a dramatic increase in the perceived level of the reliability of audited financial statements when non-audit services are provided by a separate department within the audit firm.

In the second situation (b) Table 5.25 reveals that the majority of respondents (over 80 per cent, N = 161) perceive audited financial statements to be "always" or "often" reliable when non-audit services are provided by a separate department within the audit firm. Furthermore, over 17 per cent of respondents perceive them to be "sometimes" reliable when non-audit services are provided by a separate department within the audit firm. However, only 3 respondents perceive financial statements to be "rarely" reliable when non-audit services are provided by a separate department within the audit firm. Table 5.25 also reveals that in the third situation (c) there is a further increase in the perceived level of the reliability of financial statements. As shown in the table, the majority of respondents (over 88 per cent, N = 177) perceive audited financial statements to be "always" or "often" reliable when non-audit services are provided by an audit firm not involved in the audit. In addition, 11 per cent (N = 22) of respondents perceive audited financial statements to be "sometimes" reliable when non-audit services are provided by an audit firm not involved in the audit.

However, in the fourth situation (d), table 5.25 reveals an apparent decrease in the perceived level of the reliability of financial statements when non-audit services are provided by an auditor to all clients even though a full disclosure is made in the client's financial statements. It can be noted from table 5.25 that 63 per cent (N = 128) of respondents perceive audited financial statements to be "always" or "often"

reliable when non-audit services are provided by the auditor to all clients and full disclosure is made in the client's financial statements. Table 5.25 also shows that over 32 per cent (N = 65) perceive audited financial statements to be "sometimes" reliable when non-audit services are provided by the auditor to all clients but full disclosure is made in the client's financial statements. However, 3 per cent (N = 6) perceive audited financial statements to be "rarely" or "never" reliable when non-audit services are provided by the auditor to all clients, but full disclosure is made in the client's financial statements.

Table 5.25: The Impact of NAS on the RAFS

RAFS when NAS is provided to audited company by:	N	%
(a) personnel involved in the audit		
Always	52	26.1
Often	79	39.7
Sometimes	40	20.1
Rarely	27	13.6
Never	1	0.5
	199	100.00
(b) a separate department within the audit firm		
Always	57	28.6
Often	104	52.3
Sometimes	35	17.6
Rarely	3	1.5
Never	0	0.00
	199	100
(c) by an audit firm not involved in the audit		
Always	54	27.2
Often	123	61.8
Sometimes	22	11.0
Rarely	0	0.00
Never	0	0.00
	199	100
(d) by the auditor to all clients, but full disclosure is made in the client's financial statements		
Always	45	22.6
Often	83	41.7
Sometimes	65	32.7
Rarely	2	1.0
Never	4	2.0
	199	100

5.6.6 Legal Incentives and the RAFS

The effect of the legal incentives variable is described in table 5.26. It can be seen from this table that 82 per cent (N = 163) of respondents perceive the audited financial statement to be "always" or "often" reliable when they are audited within an audit market where strict legal incentives exist. Furthermore, over 16 per cent (N = 33) of respondents perceive audited financial statements to be "sometimes" reliable when audited within an audit market where strict legal incentives exist. However, 3 respondents perceive them to be "rarely" or "never" reliable. It can be noted that there is a decrease in the perceived level of reliability of audited financial statements when an audit is performed in an audit market which lacks legal incentives. Table 5.26 shows that 62 per cent (N = 125) of respondents perceive audited financial statements to be "always" or "often" reliable when they are audited within an audit market that lacks strict legal incentives which may regulate the auditor's independence.

Table 5.26: The Impact of Legal Incentives on the RAFS

Reliability of financial statements audited within audit market:	N	%
Where strict legal incentives exist		
Always	42	21.1
Often	121	60.8
Sometimes	33	16.6
Rarely	2	1.0
Never	1	0.5
	199	100
Which lacks legal incentives		
Always	6	3.0
Often	119	59.8
Sometimes	70	35.2
Rarely	3	1.5
Never	1	0.5
	199	100

5.6.7 Audit Committee and the RAFS

The impact of an audit committee can be revealed from table 5.27. It can be noted from this table that over 86 per cent (N = 172) of respondents perceive financial statements to be "always" or "often" reliable when an audited entity has an audit committee. Furthermore, a remaining 13 per cent (N = 27) of respondents perceive audited financial statements to be "sometimes" reliable when the audited entity has an

audit committee. However, it can be noted that there is a massive decrease in the perceived level of reliability of audited financial statements when the audited entity does not have an audit committee.

Table 5.27 reveals that over 61 per cent (N = 122) perceive audited financial statements to be "always" or "often" reliable when an audited entity does not have an audit committee. Furthermore, 22 per cent (N = 44) of respondents perceive audited financial statements to be "sometimes" reliable when the audited entity does not have an audit committee. Moreover, over 16 per cent (N = 33) of respondents perceive audited financial statements to be "rarely" reliable when the audited entity does not have an audit committee.

Table 5.27: The Impact of Audit Committee on RAFS

RASF when the audited entity:	N	%
has an audit committee (AC)		
Always	88	44.2
Often	84	42.2
sometimes	27	13.6
Rarely	0	0.0
Never	0	0.0
	199	100.0
does not have an audit committee (AC)		
Always	42	21.1
Often	80	40.2
Sometimes	44	22.1
Rarely	33	16.6
Never	0	0.0
	199	100.0

5.6.8 Audit Tenure and the RAFS

The audit tenure is described on three levels: audit firm level, audit partner level and audit manager level. Each level is depicted into three audit periods which are 10 years, 5 years and less than 5 years. First, it can be seen from table 5.28 that over 64 per cent (N = 129) of respondents perceive financial statements to be "always" or "often" reliable when audited by the same audit partner for 10 years. A further 5 per cent (N = 10) perceive financial statements to be "sometimes" reliable when audited by the same audit firm for 10 years. However, as shown in table 5.28, over 30 per cent (N = 60) of respondents perceive financial statements to be "rarely" reliable when audited by the same audit firm for 10 years.

It can also be argued that there is a slight increase in the perceived reliability of financial statements when audited by the same audit firm for 5 years. Short audit firm tenure increases perceived reliability of financial statements. It can be seen from table 5.28 that over 65 per cent (N = 131) perceive financial statements to be "always" or "often" reliable when audited by the same audit firm for 5 years. Moreover, 34 per cent (N = 68) of respondents perceive financial statements to be "sometimes" reliable.

Table 5.28: The Impact of Audit Firm Tenure on RAFS

RAFS when audited by the same audit firm for:	N	%
10 Years		
Always	48	24.1
Often	81	40.7
Sometimes	10	5.0
Rarely	60	30.2
Never	0	0.0
	199	100.0
5 Years		
Always	74	37.2
Often	57	28.6
Sometimes	68	34.2
Rarely	0	0.0
Never	0	0.0
	199	100.0
Less than 5 Years		
Always	68	34.2
Often	116	58.3
Sometimes	14	7.0
Rarely	1	0.5
Never	0	0.0
	199	100.0

It can also be noted that there is a dramatic increase in the perceived reliability of financial statements when audited by the same audit firm for less than five years. This means that the shorter the audit firm tenure, the more reliable the audited financial statements are perceived to be. Table 5.28 reveals that over 92 per cent (N = 184) perceive financial statements to be "always" or "often" reliable when audited by the same audit firm for less than five years. In addition, it can be seen from table 5.28 that 7 per cent (N = 14) of respondents perceive financial statements to be "sometimes" reliable when audited by the same audit firm for less than five years. However, only one respondent perceives financial statements to be "rarely" reliable when audited by the same audit firm for less than five years.

Secondly, table 5.29 reveals the results related to the audit partner tenure. It can be seen that over 58 per cent (N = 117) of respondents perceive financial statements to be "always" or "often" reliable when audited by the same audit partner for 10 years. A further 8 per cent (N = 17) of respondents perceive financial statements to be "sometimes" reliable. However, over 30 per cent (N = 61) of respondents perceive financial statements to be "rarely" reliable when audited by the same audit partner for 10 years. Moreover, 2 per cent (N = 4) of respondents perceive financial statements to be "never" reliable when audited by the same audit partner for 10 years.

It can be noted from table 5.29 that there is an increase in the level of perceived reliability of audited financial statements when the audit partner tenure is reduced from 10 to 5 years. Table 5.29 reveals that over 61 per cent (N = 124) of respondents perceive financial statements to be "always" or "often" reliable when audited by the same audit partner for 5 years. In addition, over 34 per cent (N = 69) of respondents perceive financial statements to be "sometimes" reliable. However, over 3 per cent (N = 6) of respondents perceive financial statements to be "rarely" or "never" reliable when audited by the same audit partner for 5 years.

Table 5.29 also reveals a dramatic increase in the level of perceived reliability of audited financial statements when the audit partner tenure is reduced from 5 years to less than five years. It can be noted that over 88 per cent (N = 178) of respondents perceive financial statements to be "always" or "often" reliable when audited by the same audit partner for less than five years. Furthermore, 7 per cent (N = 14) of respondents perceive financial statements to be "sometimes" reliable when financial statements are audited by the same audit partner for less than five years. However, over 3 per cent (N = 7) of respondents perceive financial statements to be "rarely" or "never" reliable when audited by the same audit partner for less than 5 years.

Table 5.29: The Impact of Audit Partner Tenure on the RAFS

RAFS when audit partner is in charge of company's audit for:	N	%
10 years		
Always	47	23.6
Often	70	35.2
Sometimes	17	8.5
Rarely	61	30.7
Never	4	2.0
	199	100
5 years		
Always	69	34.7
Often	55	27.6
Sometimes	69	34.7
Rarely	2	1.0
Never	4	2.0
	199	100
Less than 5 years		
Always	69	34.67
Often	109	54.77
Sometimes	14	7.04
Rarely	3	1.51
Never	4	2.01
	199	100

Thirdly, table 5.30 reveals the results related to the audit manager tenure. It can be seen from this table that over 57 per cent (N = 115) perceive financial statements to be "always" or "often" reliable when the audit manager has been in charge for the entity's audits for 10 years. There is also over 11 per cent (N = 23) of respondents who perceive financial statements to be "sometimes" reliable when the audit manager has been in charge for the entity's audits for 10 years. However, over 30 per cent (N = 61) of respondents perceive financial statements to be "rarely" or "never" reliable when the audit manager has been in charge for the entity's audits for 10 years.

It can also be revealed from table 5.30 that there is a slight increase in the level of perceived reliability of audited financial statements when reducing the audit manager's tenure from 10 years to 5 years. Table 5.30 shows that over 61 per cent (N = 123) perceive financial statements to be "always" or "often" reliable when an audit manager has been in charge for the entity's audits for 5 years. In addition, over 35 per cent (N = 70) of respondents perceive financial statements to be "sometimes" reliable when the audit manager has been in charge of the entity's audits for 5 years. However, 3 per cent (N = 6) of respondents perceive financial statements to be

"rarely" or "never" reliable when an audit manager has been in charge for the entity's audits for five years.

It can also be revealed from table 5.30 that there is a dramatic increase in the level of perceived reliability of financial statements when reducing audit manager tenure from five to less than five years. Table 5.30 shows that over 89 per cent (N = 179) of respondents perceive financial statements to be "always" or "often" reliable when an audit manager has been in charge of the entity's audits for less than five years. Moreover, over 6 per cent (N = 13) of respondents perceive financial statements to be "sometimes" reliable when an audit managers has been responsible for the entity's audits for less than five years. However, over 3 per cent (N = 7) of respondents perceive financial statements to be "rarely" or "never" reliable when an audit manager has been responsible for the entity's audits for less than five years.

Table 5.30: The Impact of Audit Manager Tenure on the RAFS

RAFS when audit manager is in charge of the company's audit for:	N	%
10 years		
Always	42	21.1
Often	73	36.7
Sometimes	23	11.6
Rarely	57	28.6
Never	4	2.0
	199	100
5 years		
Always	65	32.6
Often	58	29.2
Sometimes	70	35.2
Rarely	3	1.5
Never	3	1.5
	199	100
Less than 5 years		
Always	71	35.7
Often	108	54.3
Sometimes	13	6.5
Rarely	3	1.5
Never	4	2.0
	199	100

It can be concluded that there is some difference in perceptions about the three lengths of audit manager tenure, as perceived by the respondents in table 5.30.

5.6.9 The Impact of Social Relationships on the RAFS

The influence of social relationships on the perceived reliability of audited financial statements, is highlighted in table 5.31. It can be revealed that over 57 per cent (N = 114) perceive audited financial statements to be "always" or "often" reliable when the auditor has a social relationship with the audit client. A further 37 per cent (N = 74) perceive audited financial statements to be "sometimes" reliable when the auditor has a social relationship with the audit client. However, 11 respondents perceive audited financial statements to be "rarely" reliable when the auditor has a social relationship with the audit client. It can be noted that there is an increase in the perceived level of reliability of audited financial statements when the auditor does not have a social relationship with the client. Table 5.31 reveals that the majority (over 96 per cent, N = 194) of respondents perceive audited financial statements to be "always" or "often" reliable when the auditor does not have a social relationship with the audit client.

Table 5.31:The Impact of Social Relationship on the RAFS

RAFS when audit is performed when	N	%
Auditors have social relationships with the client(s)		
Always	2	1.0
Often	112	56.3
Sometimes	74	37.2
Rarely	11	5.5
Never	0	0.0
Total	199	100.0
Auditors have no social relationships with the client(s)		
Always	95	47.7
Often	99	49.8
Sometimes	5	2.5
Rarely	0	0.0
Never	0	0.0
Total	199	100.0

5.7 Audit Dispute (Auditors' Responses)

Table 5.32 reveals that 79 per cent (N = 34) of the respondents (the auditors' group to whom only this question is applicable) state that they have had a dispute with their clients, while 21 per cent of the auditors' group state that they have not had a conflict with their clients. The nonparametric test shows that the mean score = 1.21, std deviation = 0.412 as a significance level of 2-Tialed $P < 0.001$. It can be concluded that auditing dispute is an important variable that gives an indication of the extent of audit dispute between auditors and their audit client(s).

Table 5.33 describes the possible reasons that may lead to a dispute between auditors and their clients. It can be seen from this table that the majority of the auditors' group (76 per cent, N = 26) state that the reason "(d) unrecorded transaction(s) that may have material impact on financial statements" is the mean cause of audit dispute while the reason "(e) client management failed to meet an agreed audit timescale" seems to be the least cause of audit dispute between auditors and their clients. It should be noted that the total number of the auditors' group who responded to this questionnaire is 43 auditors, 9 of whom answered "no" to any dispute with their clients (see table 5.32). This produces a total number of 34 auditors to whom this question is applicable, as described in table 5.33.

To determine whether these differences are of any significance, nonparametric tests were undertaken. The results of these tests show a significant difference between these reasons at a $P < 0.05$ level. Comparisons between these reasons show a significant difference at 0.05 level, however, comparisons between (c) & (b); (d) & (b); (e) & (b); (b) & (a); (c) & (a); and (d) & (a) show no significant difference at 0.05 level as shown in table 5.34. It can be seen that the reason (d) "unrecorded transaction(s) which may have material impact on the financial statements" is perceived to be the key reason that cause audit disputes between auditors and clients. The results of nonparametric tests indicate that the mean rank based on the Friedman Two-Way ANOVA is highest (MR = 3.40) at the reason (d).

Table 5.35 describes the consequences and the outcomes of an audit dispute that may occur between auditors and their audit clients (managers). This is from the perspective of the auditors' group. It can be seen from table 5.35 that the majority (74 per cent, N = 25) of the auditors' group state that they have issued an adverse audit report as a result of the audit dispute. In order to determine whether this result is significant, nonparametric tests were undertaken. The results show a mean score of 1.26, std. deviation = 0.448 at a significance $p < 0.01$ level. It should be noted that the auditors' group consists of 43 individuals excluding nine auditors who state that they have no dispute with their audit clients. However, it can also be seen from table 5.35 that over 65 per cent of the auditors' group (N = 22) state that they have lost their client as a result of an audit dispute, while 35 per cent (N = 12) of the auditors' group state that they have not lost their audit client even though a dispute exists between the

auditor and their clients. It can be concluded that audit disputes may lead to a loss of audit clients.

Table 5.32: Audit Dispute (Auditors' Responses)

Auditors have conflict with their clients		N	%
	Yes	34	79.1
	No	9	20.9
		43*	100
Binomial Test	**Mean**	**Std. Deviation**	**Significance 2-Tailed**
	1.21	0.412	0.000
*Auditors group who responded to the questionnaire survey			

Table 5.33: Reasons for Cause of Audit Dispute (Auditors' Responses)

Reasons for cause of audit dispute		N	%
(a) Discovering improper accounting treatment			
	No	9	26.47
	Yes	25	73.53
		*34	100
(b) Switching between accounting rules that results in material difference to income			
	No	15	44.12
	Yes	19	55.88
		*34	100
(c) Inadequate disclosure regarding item(s) within financial statements			
	No	16	47.06
	Yes	18	52.94
		*34	100
(d) Unrecorded transaction(s) that may have material impact on financial statements.			
	No	8	23.53
	Yes	26	76.47
		*34	100
(e) Client management failed to meet agreed audit timetable	No	19	55.88
	Yes	15	44.12
		*34	100
*Auditors' group 43 excluding 9 individuals to whom this question is not applicable.			

Table 5.34: Ranking of Audit Dispute Reasons (Auditors' Responses)

Friedman Two-Way ANOVA Test	
****Mean Rank**	**Reasons caused an audit dispute (Auditors Responses)**
3.32	(a) Discovering improper accounting treatment(s)
2.88	(b) Switching between accounting rules that result in material difference
2.81	(c) Inadequate disclosure regarding item (s) in the financial statements
3.40	(d) Unrecorded transaction(s) that may have material impact
2.59	(e) Client's managers fail to meet agreed audit timescale
Number of cases = 34; Chi-square = 10.2587; D.F = 4; P = 0.0364	

Wilcoxon Matched-Pairs Signed-Ranks Tests

	-Ranks MR	-Ranks Cases	+Ranks MR	+Ranks Cases	Ties Cases	Test Results
(a) & (e)	8.50	13	8.50	3	18	z = -2.5000; p = 0.0124*
(c) & (d)	7.50	3	7.50	11	20	z = -2.1380; p = 0.0325*
(d) & (e)	9.00	14	9.00	3	17	z = -2.6679; p = 0.0076*

-Ranks The first reason perceived to be more crucial in causing audit dispute than the second reason

+Ranks The first reason perceived to be less crucial in causing audit dispute than the second reason

Comparison of (c) & (b); (d) & (b); (e) & (b); (b) & (a); (c) & (a); and (d) & (a) show no significant difference (at the P = 0.05 level).

* 2-Tailed Probability

MR mean rank is the sum of the ranks divided by the number of cases

**The higher the mean rank the more important the reason causing a dispute

Table 5.35: Issuing an Adverse Audit Report

Issuance of adverse report		**N**	**%**
Yes		25	74.00
No		9	26.00
		34*	100
Binomial Test	**Mean**	**Std. Deviation**	**Significance 2-Tailed**
	1.26	0.448	0.009
Losing client as a result of audit dispute		**N**	**%**
Yes		22	65.00
No		12	35.00
		34*	100
Binomial Test	**Mean**	**Std. Deviation**	**Significance 2-Tailed**
	1.35	0.485	0.121

*Auditors' group 43 excluding 9 respondents who answered No to this question.

5.8 Audit Dispute (Managers' Responses)

Table 5.36 reveals that over 80 per cent (N = 26) of the managers' group state that they have a dispute with their auditors. However, 6 managers state that they have no dispute with their auditors. As shown in table 5.36, nonparametric tests indicate that there is a significant difference in the response to the audit dispute at a significance level $p < 0.001$, mean score = 1.19, std deviation = 0.397. It can be concluded that managers have experienced audit conflict with their auditors. It should be noted that the managers' group consists of 32 individuals who responded to the questionnaire survey and to whom this question is applicable.

Table 5.37 reveals the frequency of the reasons that may cause an audit dispute between managers and their auditors. It can be seen from this table that the highest percentage which is over 90 per cent (N = 24) of the managers' group state that the reason (b) "switching between accounting rules that may result in material difference to income" is perceived to be the reason that causes audit disputes between clients and auditors. However, it can also be seen from table 5.37 that the reason (c), "inadequate disclosure regarding item(s) within financial statements", appears to be the least reason that may result in an audit dispute between clients and auditors. It should be noted that the total number of the managers' group who responded to this questionnaire is 32 managers, 6 of them answered "no" to having a dispute with their auditors (see table 5.36). This produces a total number of 26 managers to whom this question is applicable which is introduced in table 5.37.

In order to determine whether the differences in these reasons, nonparametric tests were undertaken. The results of the Friedman two-way ANOVA test reveals that the reason (b) is the key reason that may cause an audit dispute between managers and auditors; it can be seen from table 5.38 that the reason (b) is ranked the highest with a mean rank of 3.87 at a significance level of $P < 0.001$. Table 5.38 also shows that a comparison between reasons (a) & (c); (a) & (d); (b) & (e); and (e) & (d) show no significance at $p < 0.05$ level. While, as can be seen from table 6.38, a comparison of reasons (a) & (b); (a) & (e); (b) & (c); (b) & (d); and (c) & (d) show a significant difference at $p < 0.05$ level.

Table 5.36: Audit Dispute (Managers' Responses)

Managers' conflict with auditors		N	%
Yes		26	81.25
No		6	18.75
Total		32	100
Binomial Test	**Mean**	**Std. Deviation**	**Significance 2-Tailed**
	1.19	0.397	0.001

Table 5.37: Reasons for Audit Disputes (Managers' Responses)

Reasons led to audit dispute	N	%
(a) Time pressure caused by late adjustments		
No	17	65.40
Yes	9	34.60
	26*	100
(b) Switching between accounting rules		
No	2	7.70
Yes	24	92.30
	26*	100
(c) Inadequate disclosure regarding item(s)		
No	22	84.60
Yes	4	15.40
	26*	100
(d) Unrecorded transaction(s)		
No	9	34.60
Yes	17	65.40
	26*	100
(e) Non-compliance to accounting rules or flexible use of accounting practice		
No	5	19.20
Yes	21	80.80
	26*	100
*Managers group 32 excluding 6 individuals to whom this question is not applicable.		

Table 5.39 reveals that 58 per cent (N = 15) of the managers' group state that they received an adverse audit report following an audit dispute with their auditors, while 42 per cent (N = 11) of respondents state that they have not received such an audit report. However, it can be revealed from table 5.39 that the results of nonparametric tests show no significant difference at p = 0.557. Furthermore, table 5.39 shows that over 70 per cent (N = 20) of the managers' group state that they replaced their auditor as a result of audit conflict while 23 per cent (N = 6) of managers state that they did

not replace their auditors. The results of nonparametric tests show that there is a significant difference between the two answers at a significance level where $p < 0.05$. It should be noted that the total number of the managers' group is 32 individuals, 6 of who state that they have no dispute with their auditors (see table 5.36). This produces a total number of 26 managers to whom this question is applicable.

Table 5.38: Ranking of Audit Dispute Reasons (Managers' Responses)

Friedman Two-Way ANOVA Test

****Mean Rank**	**Reasons leading to audit dispute (Managers' Responses)**
2.42	(a) Conflict due to time pressure & late adjustments
3.87	(b) Switching between accounting rules
1.94	(c) Inadequate disclosure regarding items(s)
3.19	(d) Unrecorded transaction(s)
3.58	(e) Non-compliance to accounting rules or flexible use of accounting practice

Number of cases = 26; Chi square = 37.0666; D.F = 4; P < 0.0001

Wilcoxon Matched-Pairs Signed-Ranks Tests

	-Ranks		**+Ranks**		**Ties**	**Test Results**
	MR	**Cases**	**MR**	**Cases**	**Cases**	
(a) & (b)	9.00	1	9.00	16	9	z = -3.6380; p = 0.000*
(a) & (e)	8.50	2	8.50	14	10	z = -3.0000; p = 0.003*
(b) & (c)	11.50	21	11.50	1	4	z = -4.2640; p = 0.000*
(b) & (d)	6.00	9	6.00	2	15	z = -2.1106; p = 0.035*
(c) & (d)	8.00	1	8.00	14	11	z = -3.3566; p = 0.001*

-Ranks The first reason perceived to be more crucial in causing audit dispute than the second reason

+Ranks The first reason perceived to be less crucial in causing audit dispute than the second reason

Comparison of (a) & (c); (a) & (d); (b) & (e); and (e) & (d) showed no significant difference (at the P = 0.05 level).

* 2-Tailed Probability

MR Mean rank is the sum of the ranks divided by the number of cases.

** The higher the mean rank the more important the reason causing dispute.

Table 5.39: Receiving an Adverse Audit Report

Receiving an adverse report			N	%
Yes			15	58.00
No			11	42.00
			*26	100.00
Binomial Test	**Mean**	**Std. Deviation**	**Sig 2- Tailed**	
	1.42	0.504	0.557	
Replacing the auditor as a result of audit dispute			**N**	**%**
Yes			20	77.00
No			6	23.00
			*26	100.00
Binomial Test	**Mean**	**Std. Deviation**	**Sig 2-Tailed**	
	1.23	0.430	0.009	
*Managers group 32 excluding 6 individuals to whom this question is N/A				

5.9 Summary

This chapter provides descriptive analysis about the factors affecting the perceived auditor independence and the perceived reliability of audited financial statements within an emerging audit market in Libya. It can be concluded from this analysis that all eight factors examined are important. For instance, OILMAs perceive that the provision of non-audit services and the lack of legal incentives among audit markets undermine auditor independence. They also perceive that the existence of an audit committee and the rotation of auditors are perceived to protect and enhance the independence of auditors as well as the perceived reliability of audited financial statements. However, in order to determine whether or not the above results are significant, the following chapter is devoted to statistically examining the results of the questionnaire, which entails the testing of the hypotheses of this research.

Chapter 6

Hypotheses Testing

6.1 Introduction

The pervious chapter provides descriptive analysis of the questionnaire results. It is concluded from this analysis that all eight factors examined are important. For instance, OILMAs perceive that the provision of non-audit services and the lack of legal incentives among audit market undermine auditor independence. They also perceive that the existence of audit committee and the rotation of auditors are perceived to protect and enhance the independence of auditors as well as the perceived reliability of audited financial statements. This chapter is dedicated to test the research hypotheses. H_1 through H_8 investigate the influence of the eight factors (identified in chapter 3) on the perceptions of auditor independence at the total sample level. Further analysis is carried out to examine these factors at the subgroup level, in order to examine whether the five groups hold the same perceptions toward the auditor independence, hypotheses H_{1a} through H_{8a}.

H_1 through to H_8 investigated the influence of the eight factors on the perceptions of auditor independence at the total sample level. Further analysis was carried out to examine these factors at the subgroup level, in order to examine whether the five groups hold the same perceptions toward auditor independence (see hypotheses H_{1a} through to H_{8a}). These hypotheses were examined using t–test statistics. In addition, the effect of these eight factors on the perceived reliability of audited financial statements, is also examined (see H_{1b} through to H_{8b}) using nonparametric tests. Moreover, factor analysis was performed in order to examine the interrelationships between these factors, and Omega statistics were also used to measure the effect size and determine the most influential factor(s).

6.2 Examining Hypothesis H1

H_1: OILMAs' perceived auditor independence is positively affected by large audit firm size.

H_{1a}: There is a consensus among OILMAs regarding the positive effect of large audit firm size on the PAI.

H_{1b}: OILMAs consider financial statements to be more reliable when audited by one of the Big 4 audit firms than when audited by a large local audit office.

Drawing on the descriptive analysis, it is suggested that the majority of respondents have more confidence in the independence of large local audit offices and Big 4 audit firms than small local audit offices. In an attempt to demonstrate whether this conclusion is statistically significant, a series of t-test were performed at the total sample level as well as at the subgroups level. Table 6.1 shows, at the total sample, significant mean scores for the Big 4 auditors, large audit offices and small audit offices (3.77, 4.20, and 1.82, P = 0.000) respectively. Thus H_1 is supported. This means that respondents believe that large auditors are more independent than small local auditors.

A series of t-tests were also performed comparing the means of the five groups of respondents for each variable. Although Big 4 audit firms and large audit offices are significant variables among the total sample, there are differences in the relative importance of these variables. It can be seen from table 6.1 that for the owners, a large audit office is more important than for other sub-samples, with the highest mean score of 4.74. However, the investors perceive that large audit offices and Big 4 auditors have no effect on auditor independence. Table 6.2 demonstrates the diversity of t-values across subgroups regarding the effect of audit firm size. This indicates a difference in the relative importance of audit firm size among subgroups. Therefore H_{1a} is rejected. This means that the investors' group has no confidence in the independence of large local audit firms, although all groups perceive that the independence of small auditors is undermined (see table 6.1 and 6.2).

The H_{1b} is set to examine the effect of audit firm size on the perceived reliability of audited financial statements. The majority of respondents perceive that financial statements audited by a large audit office is more reliable than those audited by a Big 4 audit firm. In order to determine whether this difference between the two sizes is significant, nonparametric tests were performed. Nonparametric tests (Wilcoxon Signed Ranks Test) indicate a significant difference at the $P = 0.000$. The results in table 6.3 show a high mean rank of 60.50 at P = 0.000. Thus, the results were not as expected, which supports the notion of rejecting H_{1b}. This means that respondents within the Libyan audit market have more confidence in the financial statements audited by a large local audit office than those audited by one of the Big 4 audit firms.

Table 6.1 : The Perceptions of Auditor Independence at Total Sample Level and each Subgroup Level

Panel A[52]	Total Sample		Owners		Investors		Lenders		Managers		Auditors	
	Mean	P	Mean	P	Mean	P	Mean	P	Mean	P	Mean	P
1 FEE	2.44	0.000	2.16	0.000	2.00	0.000	2.75	0.031	2.34	0.000	2.77	0.011
2 NAS	1.97	0.000	1.16	0.000	2.12	0.000	2.35	0.000	1.72	0.044	2.14	0.000
3 NASNC	3.04	0.263	2.87	0.211	2.90	0.103	3.16	0.010	3.13	0.000	3.07	0.323
4 LEGAL	1.50	0.000	1.39	0.000	1.38	0.000	1.71	0.000	1.53	0.000	1.42	0.000
5 LDISTD	1.75	0.000	2.84	0.023	1.31	0.000	1.69	0.000	1.53	0.000	1.65	0.000
6 COMPET	2.11	0.000	2.00	0.000	1.81	0.000	3.02	0.917	2.03	0.000	1.47	0.000
7 SMLOFC	1.82	0.000	1.16	0.000	1.62	0.000	2.35	0.000	1.81	0.000	1.86	0.000
8 SOCIAL	1.94	0.000	2.39	0.000	1.90	0.000	1.71	0.000	2.00	0.000	1.88	0.000
Panel B[53]												
9 BIG4AUD	3.77	0.000	4.13	0.000	2.71	0.194	4.27	0.000	3.97	0.000	3.79	0.000
10 LRGOFC	4.20	0.000	4.74	0.000	2.93	0.752	4.49	0.000	4.59	0.000	4.4	0.000
11 AC	3.66	0.000	3.26	0.003	2.83	0.351	3.82	0.000	4.38	0.000	4.02	0.000
12 ROTATE	3.94	0.000	4.23	0.000	3.02	0.915	4.18	0.000	4.25	0.000	4.14	0.000

[52]Factors undermine auditor independence: FEE = one-client audit fees exceed 15 per cent of total audit revenue, NAS = auditors provide non-audit services to audit client, NASNC = auditors provide non-audit services to non-audit client, LEGAL = audit market lacks legal incentives, LDISTD = audit market lacks domestic independence standards, COMPET = audit service is performed within high competitive audit market, SMLOFC = audit service is performed by small audit office, SOCIAL = influence of Libyan social relationships.

[53]Factors enhance auditor independence: BIG4AUD = audit is performed by one of the Big 4 auditors, LRGOFC = audit is performed by large audit office, AC= audit committee exists within audit client's company, ROTATE = rotating auditors every 5 years.

Table 6.2: t- values at the Total Sample Level as well as at the Subgroups Level

Variables[54] Tested	TS[55] t-value	P*	Owners t-value	P*	Investors t-value	P*	Lenders t-value	P*	Managers t-value	P*	Auditors t-value	P*
BIG4AUD	10.50	0.000	8.75	0.000	-1.32	0.194	13.09	0.000	9.21	0.000	8.64	0.000
LRGOFC	16.10	0.000	21.80	0.000	-0.32	0.752	21.08	0.000	13.55	0.000	18.50	0.000
FEE	**-10.90**	0.000	**-12.49**	0.000	**-8.85**	0.000	**-2.22**	0.031	**-6.17**	0.000	**-2.67**	0.011
AC	10.00	0.000	3.23	0.003	-0.94	0.351	7.67	0.000	10.35	0.000	16.46	0.000
NAS	**-19.17**	0.000	**-27.38**	0.000	**-7.40**	0.000	-5.63	0.000	**-13.87**	0.000	-10.94	0.000
NASNC	1.12	0.263	-1.28	0.211	-1.67	0.103	2.68	0.010	2.10	0.044	1.00	0.323
ROTATE	13.96	0.000	16.06	0.000	0.11	0.915	10.95	0.000	12.45	0.000	21.31	0.000
LEGAL	**-35.21**	0.000	**-18.14**	0.000	**-21.35**	0.000	**-12.67**	0.000	**-12.38**	0.000	**-20.77**	0.000
LDISTD	**-23.92**	0.000	**-2.40**	0.023	**-23.41**	0.000	**-13.27**	0.000	**-13.37**	0.000	**-18.34**	0.000
COMPET	**-12.25**	0.000	**		**-8.67**	0.000	0.10	0.917	**-9.21**	0.000	**-19.94**	0.000
SMLOFC	**-24.24**	0.000	**-27.38**	0.000	**-16.61**	0.000	**-7.02**	0.000	**-11.34**	0.000	**-12.44**	0.000
SOCIAL	**-28.31**	0.000	**-6.89**	0.000	**-12.32**	0.000	**-14.40**	0.000	**		**-22.57**	0.000

[54] FEE = one-client audit fees exceed 15 per cent of total audit revenue, NAS = auditors provide non-audit services to audit client, NASNC = auditors provide non-audit services to non-audit client, LEGAL = audit market lacks legal incentives, LDISTD = audit market lacks domestic independence standards, COMPET = audit service is performed within high competitive audit market, SMLOFC = audit service is performed by small audit office, SOCIAL = influence of Libyan social relationships. BIG4AUD = audit is performed by one of the Big 4 auditors, LRGOFC = audit is performed by large audit office, AC= audit committee exists within audit client's company, ROTATE = rotating auditors every 5 years.

[55] Total Sample level.

** t-value can not be computed, because standard deviation is zero.

P* 2-tailed significance.

Table 6.3: Impact of Audit Firm Size on the RAFS

Wilcoxon Signed Ranks Test			
***Mean Rank**	**Cases**		
60.50	85	- Ranks	A)
50.92	30	+ Ranks	B)
	84	Ties	C)
	199		

Z = -5.4681; 2-Tailed P = 0.000

A) Financial statements audited by large audit office ranked more reliable than those audited by Big 4 audit firm
B) Financial statements audited by large audit office ranked less reliable than those audited by Big 4 audit firm
C) Financial statements audited by large audit office and by Big 4 ranked equally in terms of reliability
* Mean rank is the sum of the ranks divided by the number of cases.

6.3 Examining Hypothesis H2

H_2: Owners, investors, lenders, managers, and auditors' (OILMAs, hereafter) perceived auditor independence (PAI hereafter) is negatively affected when one-client audit fee exceeds 15 per cent of the total audit revenue.

H_{2a}: There is a consensus among OILMAs regarding the impact of high audit fees on the perceived auditor independence.

H_{2b}: OILMAs' perceived reliability of audited financial statements is negatively affected when one-client audit fee exceeds 15 per cent of the total audit revenue.

The descriptive analysis suggests that the high audit fee has an impact on perceived auditor independence among users and auditors in the Libyan audit market. In order to test whether the impact of the audit fee is statistically significant at the total sample level (H2), and at each subgroup of users (H2a), a series of t-tests were performed. To accept the hypotheses, the statistical *P* value should be significant[56]. In addition, the test value used in the current investigation is 3, therefore any significant results below 3 indicates a negative impact, while any significant results "mean" above 3 indicates a positive impact. The results presented in table 6.1 show a significant impact as one-client audit fees exceed 15 per cent of the total audit revenue (mean = 2.44, P = 0.000). Therefore, the hypothesis H_2 is accepted, which means that higher audit fees received from one audit client threatens and impairs auditor independence within the Libyan audit market. This is at the total sample level.

[56] *P* value is significant when it is equal to or less than the alpha value of 0.05.

At the subgroups level, hypothesis H_{2a} examines the effect of the audit fees size on the perceptions of auditor independence as perceived by each group separately. Table 6.1 also reveals that the mean scores of owners, investors, lenders managers, and auditors are 2.16, 2.00, 2.75, 2.34, 2.77 respectively and all P values are statistically significant, less than the α value of 0.05. This indicates that there seems to be a consensus among all subgroups that high audit fees threaten auditor independence. More specifically, all subgroups share similar perceptions, i.e. that when one-client audit fees exceed 15 per cent of the total audit revenue, auditor independence is impaired. Thus, H_{2a} is supported. However, the differences in t-values across the subgroups level, as shown in table 6.2 suggest that there is a difference in the relative importance of the effect of the audit fee size. This means that the size of audit fees has a stronger effect on investors than on the others.

The descriptive analysis showed that when one-client audit fees do not exceed 15 per cent of the total audit revenue, the financial statements were perceived to be more reliable than when audited by auditors who receive higher audit fees – those which exceed 15 per cent of their total audit revenue from one client. In order to determine whether the difference between the two levels of audit fees are significant, nonparametric tests were undertaken. The results in table 6.4 indicate that there is significant difference at P = 0.000, mean rank = 76.16. The Wilcoxon Matched-Pairs Signed-Ranks Tests show that 130 cases of respondents perceive that financial statements are more reliable when an audit fee, from one client, does not exceed 15 per cent of the total audit revenue than when the audit fee exceeds 15 per cent. Thus H_{2b} is accepted. In other words, the higher the audit fees from one client, the lower the reliability of audited financial statements are perceived to be.

Table 6.4: The Impact of Audit Fee Size on the RAFS

Wilcoxon Matched-Pairs Signed-Ranks Tests			
***Mean Rank**	**Cases**		
76.16	130	(A)	- Ranks
38.50	14	(B)	+ Ranks
	55	(C)	Ties
	199		

Z = - 9.5368; 2-Tailed P = 0.000

(A) Financial statements, when audit fee from one client does not exceed 15 % of total audit revenue, ranked more reliable than when audit fee exceeds 15 %

(B) Financial statements, when audit fee from one client does not exceed 15 % of total audit revenue, ranked less reliable than when audit fee exceeds 15 %

(c) Financial statements ranked of equal reliability whether or not audit fee from one client exceeds 15 % of total audit revenue

* Mean rank is the sum of ranks divided by number of cases.

6.4 Examining Hypothesis H3

H_3: OILMAs' perceived auditor independence is negatively affected by a high level of Libyan audit market competition.

H_{3a}: There is a consensus among OILMAs regarding the impact of competition on perceived auditor independence.

H_{3b}: OILMAs' perceived reliability of audited financial statements is negatively affected by a high level of audit competition.

The descriptive analysis suggests that a high level of audit competition within the Libyan audit market is an important variable that is perceived to threaten auditor independence. In order to determine whether this importance is statistically significant, H_3 examines the effect of a highly competitive audit market on perceived auditor independence. The results presented in table 6.1 show a significant mean score of 2.11 at P = 0.000 at the total sample level. Therefore, H_3 is accepted. This means that a high level of competition in the Libyan audit market undermines auditor independence. On the other hand, there are differences in the relative importance of competition at the sub-groups level. Table 6.1 and 6.2 show that competition has much impact on the auditors' group rather than on the other sub-groups. The auditors

perceive that performing audit services within a highly competitive audit market undermines independence. Among auditors, the audit committee factor mean score is 1.47 which is the strongest among other subgroups. Table 6.1 indicates that the investors, owners, and managers perceive that competition undermines auditors' independence with mean scores of 1.81, 2.00 and 2.03 respectively. However, lenders' mean score is 3.02, P = 0.917 which shows that competition has no effect on the audit independence as perceived by the lenders' group. Thus H_{3a} is rejected. To test H_{3b}, nonparametric tests were performed with the intention of determining whether the difference between the effects of high and low level audit market competition is significant. The results, as shown in table 6.5, which is in line with the descriptive analysis, indicates that 92 cases state that audited financial statements in low market competition is more reliable than those audited in high market competition, with a mean rank score of 72.38 at a significance level P = 0.000 as shown by the Wilcoxon Matched-Pairs Signed-Ranks test. Thus H_{3b} is accepted.

Table 6.5: The Impact of Competition on RAFS

		Wilcoxon Signed Ranks Test
***Mean Rank**	**Cases**	
72.38	92	(A) -Ranks
56.82	42	(B) +Ranks
	65	(C) Ties
	199	

Z = - 4.9238; 2- Tailed P < 0.0001

A) Financial statements audited in a low competitive audit market ranked as more reliable than those audited in a highly competitive audit market.

B) Financial statements audited in a low competitive audit market ranked as less reliable than those in a highly competitive audit market.

C) Financial statements audited in a low competitive market and those audited in a high competitive market ranked equally in terms of audit reliability.

*Mean rank is the sum of the ranks divided by the number of cases.

6.5 Examining Hypothesis H4

H_4: OILMAs' perceived auditor independence is negatively affected by the provision of non-audit services.

H_{4a}: There is a consensus among OILMAs regarding the impact of non-audit services on perceived auditor independence.

H_{4b}: OILMAs' perceived reliability of audited financial statements is negatively affected by the provision of non-audit services.

This study results report that the majority of respondents state that providing audit services to audit clients impair auditor independence. One sample t-test results indicate a significant mean score of the total sample which is 1.97 at a P value = 0.000. This statistical significance supports the acceptance of H_4 (see table 6.1). This means that providing non-audit services along with audit services to an audit client is perceived to undermine an auditor's independence. Although providing non-audit services to audit clients is significant at the total sample level, there are differences in the relative importance of non-audit services at the sub-sample level. Table 6.1 shows that non-audit services has a stronger impact on the perceptions of the owners' sub-sample, with a mean score of 1.16, followed by the managers' mean score of 1.72 (see tables 6.1 and 6.2). Moreover, lenders', investors' and auditors' mean scores are 2.35, 2.12, and 2.14 respectively. In general, providing non-auditing services to audit clients is statistically significant (α is less than 0.05) across all five sub-groups. Thus H_{4a} is supported.

In addition, Table 6.1 shows that non-audit services to non-audit clients is not of significance. It can be seen from table 6.1 that providing non-audit services to non-audit clients = (mean = 3.04, P = 0.263), which means that non-audit services to non-audit clients has no effect on the auditor's independence. However, performing t-test across the sub-samples, there appears to be a contradiction between the sub-sample's perceptions towards non-audit services to non-audit clients. The results presented in table 6.1 show that the investors, owners and auditors groups perceive that the provision of non-audit services to non-audit clients has no effect on auditors' independence. However, the lenders' and managers' groups perceive that the provision of non-audit services to non-audit clients undermine auditors' independence.

The impact of non-audit services on the perceived reliability of audited financial statements is examined in H_{4b}. The descriptive analysis presented (in table 5.25, chapter 5) shows that the vast majority of respondents perceive that the financial statements of a company are more reliable when non-audit services are provided by an audit firm not involved in the auditing of the financial statements, than when non-audit services are provided by the other three methods. In order to determine whether the

difference is significant, nonparametric tests were undertaken. The results show a significant difference at a significance of P = 0.000 level. The Friedman two way ANOVA test shows the mean ranks of each non-audit service method. It can be seen that the non-audit service provided by an audit firm not involved in the audit, scores the lower mean rank of 2.20. The lower the mean rank, the more reliable the audited financial statements are perceived to be. Thus H_{4b} is supported. Further analysis is conducted. Table 6.6 shows that the results of the Wilcoxon Matched Pairs tests which describes the results of all possible matched situations at a significance level of $P < 0.001$.

Table 6.6: Impact of Changes in the Method of NAS on RAFS

Friedman Two-Way ANOVA Test						
Mean Rank**	**Financial statements perceived to be reliable when non-audit services (NAS) are provided to the company by:**					
2.75	(a) personnel involved in the audit					
2.71	(b) auditors to all clients & full disclosure is made in the client's financial statements					
2.34	(C) separate department within the audit firm					
2.20	(d) an audit firm not involved in the audit					
Number of cases = 199; Chi-square = 46.3946; D.F = 3; P = 0.000						
	Wilcoxon Matched-Pairs signed-Ranks Tests					
	-Ranks		**+Ranks**		**Ties**	**Test Results**
	MR	**NC**	**MR**	**NC**	**NC**	
(c) & (a)	56.30	70	41.00	32	97	z = -4.6915; p = 0.000*
(d) & (a)	59.45	77	40.00	30	92	z = -5.5431; p = 0.000*
(b) & (c)	42.68	22	43.11	63	114	z = -4.3062; p = 0.000*
(b) & (d)	63.00	36	65.77	93	70	z = -5.1382; p = 0.000*

-Ranks Financial statements perceived more reliable when NAS are provided by the first rather than by the second method

+Ranks Financial statements perceived less reliable when NAS are provided by the first rather than by the second method

Comparison of (b) & (a), and (c) & (d) both pairs indicate no significant difference (at the p = 0.05 level).

MR Mean rank is the sum of the ranks divided by the number of cases.

* 2-Tailed Probability

NC Number of Cases

**The lower the mean rank the more reliable the financial statements are perceived to be

6.6 Examining Hypothesis H5

H_5: OILMAs' perceived auditor independence is negatively affected when the audit market lacks legal incentives and domestic independence standards.

H_{5a}: There is a consensus among OILMAs regarding the impact of the audit market lacking legal incentives and domestic independence standards.

H_{5b}: OILMAs' perceived reliability of audited financial statements is negatively affected when the audit market lacks legal incentives.

The results described above suggest that the lack of legal incentives and of domestic independence standards in the Libyan audit market is a crucial factor that threatens the independence of Libyan auditors. The statistical results addressed in table 6.1, at the total sample, show significant mean scores (LEGAL = 1.50 and LDISTD = 1.75, P = 0.000). Therefore, H_5 is accepted. This means that the absence of Libyan independence standards and the lack of legal and institutional incentives within the Libyan audit market increase the risk that auditors may be seen as not independent. Furthermore, at the subgroups level, all groups' mean scores are statistically significant (see table 6.1). Thus H_{5a} is supported. This means that OILMAs perceive that LEGAL & LDISTD impair auditor independence. However, there appears to be some differences in the relative importance of these two variables across the sub-groups level. Table 6.1 shows that LDISTD and LEGAL both have the stronger impact on the investors' group, with mean scores of 1.31 and 1.38 respectively. In addition, a lack of Libyan independence standards variable is apparent with the least influence being on the owners' perceptions, indicating a mean score of 2.84. Table 6.2 also reveals the differences of t-values across subgroups.

In addition, the descriptive analysis shows that financial statements are perceived to be more reliable when audited within an audit market which is highly regulated and where strict legal incentives exist, than when they are audited in an audit market which lacks legal incentives. In order to determine whether the differences between the existence and non-existence of legal incentives are significant, nonparametric tests were undertaken. The results of the Wilcoxon Matched-Pairs Signed-Ranks test show that 90 cases (with a mean rank score of 60.42, P = 0.000) perceive that financial statements, audited in an audit market which lacks legal incentives, are less reliable than those audited in a market where strict legal incentives exist (see table 6.7). A further 28 cases perceive that financial statements, audited in an audit market which lacks legal incentives, are more reliable than those audited in a market where strict legal incentives exist. Moreover 81 cases perceive equal reliability whether legal incentives exist or not. The results show a significant influence of the lack of legal incentives on the reliability of audited financial statements. Thus H_{5b} is supported.

Table 6.7: The Impact of Legal Incentives on RAFS

Wilcoxon Matched-Pairs Signed-Ranks Tests			
*Mean Rank	Cases		
56.55	28	(a)	- Ranks
60.42	90	(b)	+ Ranks
	81	(c)	Ties
	199		
Z = -5.6014; 2-Tailed	P 0.000		

(a) financial statements audited in an audit market which lacks legal incentives ranked more reliable than those audited within an audit market where strict legal incentives exist
(b) financial statements audited in an audit market which lacks legal incentives ranked less reliable than those audited within an audit market where strict legal incentives exist
(c) financial statements ranked of equal reliability whether legal incentives exist or not.

* Mean rank is the sum of ranks divided by the number of cases

6.7 Examining Hypothesis H6

H_6: OILMAs' perceived auditor independence is positively affected by the existence of an audit committee within the client's company.

H_{6a}: There is a consensus among OILMAs regarding the positive effect of the audit committee on perceived auditor independence.

H_{6b}: OILMAs' perceived reliability is positively affected by the existence of an audit committee within the client's company.

The descriptive analysis indicates that the existence of an audit committee is perceived as an important element to ensure sound corporate governance in general. An audit committee is also perceived to protect and enhance an auditor's independence among all respondents. The results shown in table 6.1 are in line with the descriptive analysis. It can be seen from table 6.1 that the audit committee mean score is 3.66, P = 0.000. This statistical significance supports the acceptance of H_6. This means that the audit committee within the audited entity is perceived as protecting and enhancing the independence of Libyan auditors.

Despite the fact that the audit committee factor is significant at the total sample level, there are differences in the relative importance of the audit committee factor across the

sub-groups level. It can be noted from table 6.1 and 6.2 that an audit committee appears to have more influence on managers' perceptions than on the other sub-groups. The audit committee factor mean score for managers is 4.38 which is the highest. Moreover, table 6.1 also shows that the mean scores of the auditors', lenders' and owners' sub-groups are 4.02, 3.82, and 3.26 respectively. However, the investors' group perceive that the existence of an audit committee within the audit client's company has no effect on the auditor's independence, with a mean score of 2.83, P = 0.351. Thus H_{6a} is rejected. This means that OILMAs do not share similar views regarding the benefit of audit committee existence within the Libyan audit market.

H_{6b} examines the effect of an audit committee on the perceived reliability of audited financial statements. The descriptive analysis above suggests that audit committee existence increases the perceived reliability of audited financial statements. In order to determine whether the increase of the perceived reliability, as a result of an audit committee, is significant, nonparametric tests were carried out.

The results, as shown in table 6.8, indicate a significant difference at a two-tailed probability level of P = 0.000. Thus H_{6b} is supported. The Wilcoxon Matched-Pairs Signed-Ranks (M-P S-R) test shows that 88 cases perceive that when there is no audit committee, financial statements ranked less reliable than when there is one.

Table 6.8: Impact of AC on the RAFS

Wilcoxon Signed Ranks Test			
***Mean Rank**	**Cases**		
39.98	29	(A)	- Ranks
65.27	88	(B)	+ Ranks
	82	(C)	Ties
	199		

Z = - 6.4720; 2-Tailed P = 0.000

A) When AC does not exist, financial statements ranked more reliable than when one exists

B) when AC does not exist, financial statements ranked less reliable than when one exists.

C) Audited financial statements ranked of equal reliability whether or not AC exists

*Mean rank is the sum of the ranks divided by the number of cases.

However, 29 cases perceive that when there is no audit committee, within an audited entity, financial statements are ranked more reliable than when one exists. It can also be seen from table 6.8 that 82 cases perceive equal reliability, whether or not an audit

committee exists. It can be argued that audit committee existence is perceived to be an important factor in assessing the reliability of financial statements.

6.8 Examining Hypothesis H7

H_7: OILMAs' perceived auditor independence is positively affected by a 5-year auditor rotation.

H_{7a}: There is a consensus among OILMAs regarding the positive effect of auditor rotation on perceived auditor independence.

H_{7b}: OILMAs' perceived reliability is positively affected by audit rotation.

The descriptive analysis also suggests that the mandatory audit rotation is an important issue in the regulation of the audit market. The statistical analysis, as shown in table 6.1, shows significant results that confer the descriptive results. More specifically, the t-tests results at the P = 0.000, and mean scores = 3.94 confirms that audit rotation is statistically significant. Thus H_7 is supported. This means that rotating auditors every 5 years would increase the perceived independence of auditors among users and auditors in the Libyan audit market. Moreover, rotating auditors is perceived to prevent the development of close relationships between auditors and their clients.

Although rotating auditors every five years is a significant factor at the total sample level, there appear to be differences in the relative importance of rotation at the sub-groups level. Table 6.1 shows that the managers' sub-sample perceive that rotating an auditor enhances auditor independence, with a mean score of 4.25 which is higher than those of owners, lenders, and auditors, with mean scores of 4.23, 4.18, and 4.14 respectively. However, the investors' group perceive that rotating auditors every five years has no effect on an auditor's independence with a mean score of 3.02. Moreover, table 6.2 reveals the differences in t-values across all five subgroups, which means that there is no consensus among subgroups regarding the effect of audit rotation. Thus H_{7a} is rejected.

Moreover, the descriptive results presented (in tables 5.28, 5.29 and 5.30, chapter 5) suggest that the mandatory rotation on a 5-yearly basis is perceived to increase the reliability of audited financial statements. In order to determine whether this increase is significant, nonparametric tests were undertaken. The results of the Friedman Two

Way ANOVA test, presented in table 6.9, shows a significant difference at $P = 0.000$. The results show the mean rank score of each audit tenure length at all three levels. The lower the mean rank, the more reliable the financial statements are perceived to be. The audit tenure for less than five years scores a mean rank of 1.70, 1.68 and 1.67 which is the lowest at the three levels (audit firm rotation, audit partner rotation and audit manager rotation respectively). While the 10-year audit rotation at the three levels indicates higher mean ranks. Thus H_{7b} is accepted. That means audit rotation at all levels every five years increases the perceived reliability of audited financial statements in the Libyan audit market.

Table 6.9: The Impact of Audit Rotation

Audit Firm Tenure			
	Friedman Two-Way ANOVA		
	***Mean Rank**	**Test results**	
10 Years	2.40	Chi-Square	78.4672
5 Years	1.90	D.F = 2	
less than 5 Years	1.70	Significance	P = 0.000
		N = 199	
Audit Partner Tenure			
	Friedman Two-Way ANOVA		
	***Mean Rank**	**Test Results**	
10 years	2.38	Chi-Square = 75.9693	
5 years	1.93	D.F = 2	
Less than 5 years	1.68	Significance	P = 0.000
		N = 199	
Audit Manager Tenure			
	Friedman Two-Way ANOVA		
	***Mean Rank**	**Test Results**	
10 years	2.39	Chi-Square = 78.9851	
5 years	1.94	D.F = 2	
Less than 5 years	1.67	Significance	P = 0.000
		N = 199	
*The lower the mean rank, the more reliable the financial statements are perceived to be.			

6.9 Examining Hypothesis H8

H_8: OILMAs' perceived auditor independence is negatively affected by Libyan social relationships.

H_{8a}: There is a consensus among OILMAs regarding the negative impact of Libyan social relationships on perceived auditor independence.

H_{8b}: OILMAs' perceived reliability of audited financial statements is negatively affected by Libyan social relationships.

The results also suggest that the social relationships, which characterise Libyan society, have a strong impact on the perceptions of auditor independence. To facilitate whether these results are statistically significant, the results of the t-tests, presented in table 6.1, show significant results at the total sample level (mean = 1.94, P = 0.000). Therefore, H_8 is accepted. That is to say that Libyan social relationships undermine an auditor's independence, as perceived by the total sample respondents. Despite the fact that social relationships are a significant factor at the total sample level, there are differences in the relative importance of social relationships across the sub-groups level. It can be noted from table 6.1 that social relationships show a stronger influence on the perception of lenders, with a mean score of 1.71. While the least influence is apparent on the owners' perceptions with a mean score of 2.39 (see table 6.1). Table 6.1 also indicates that social relationships are significant, with mean scores of 1.90, 2.00, and 1.88 as indicated by investors, managers and auditors, respectively. Thus H_{8a} is supported, which means that OILMAs share similar perceptions regarding the influence of Libyan social relationships.

Table 6.10: Impact of Social Relationships on RAFS

		Wilcoxon Signed Ranks Test	
Mean Rank	**Cases**		
68.78	131	-Ranks	(a)
42.50	4	+Ranks	(b)
	64	Ties	(c)
	199	Total	
Z= - 10.0593; 2-Tailed P < 0.001			

(a) Financial statements audited by an auditor have no social relation with clients ranked more reliable than those audited by auditor who does have a relationship.
(b) Financial statements audited by an auditor have no social relation with clients ranked less reliable than those audited by an auditor who does have a relationship.
(c) Financial statement reliability ranked equal whether or not the auditor has a social relationship with the client.

The descriptive results shown (in table 5.31, chapter 5) suggest that Libyan social relationships decrease the perceived reliability of audited financial statements. In order to determine whether the decrease is significant, nonparametric tests were undertaken. The results presented in table 6.10 show that the decrease is significant at a P < 0.001. The Wilcoxon M-P S-R test shows 131 cases (with a mean rank score of

68.78). Thus H_{8b} is accepted. This means that OILMAs perceive audited financial statements, by an auditor who does not have social relationships with the audit client, to be more reliable than those statements audited by an auditor who does have a social relationship with the client. However, only 4 cases perceive audited financial statements by an auditor who does not have a social relationship with the audit client, to be less reliable than those statements audited by an auditor who does have a social relationship with the client. Furthermore, as shown in table 6.10, 64 cases perceive equal reliability of audited financial statements whether or not the auditor has a social relationship with the audit client.

6.10 Factor Analysis of Factors Affecting Auditors' Independence

It has been argued by Pallant (2007) that there are two conditions which are required for the data to be suitable for factor analysis. First, the Kaiser-Meyer-Oklin (KMO) Measure of Sampling Adequacy (MSA) value must exceed 0.60. Second, Bartlett's Test of Sophericity should be significant at 0.05 or smaller. Therefore, table 6.11 shows that the data is suitable for factor analysis, as the MSA value is 0.71, which is greater than the minimum required value of 0.6, and Bartlett's Test of Sophericity is significant, at less than the α value of 0.05 (see table 6.11).

Table 6.11: MSA and Bartlett's Test and explanation of total variance

Initial Eigenvalues				Extraction Sums of Squared Loadings		
Component	**Total**	**% of Variance**	**Cumulative %**	**Total**	**% of Variance**	**Cumulative %**
1	3.66	30.48	30.48	3.66	30.48	30.48
2	1.87	15.58	46.06	1.87	15.58	46.06
3	1.51	12.57	58.63	1.51	12.57	58.63
4	1.07	8.95	67.57	1.07	8.95	67.57
5	0.85	7.10	74.67			
6	0.70	5.83	80.51			
7	0.63	5.23	85.73			
8	0.54	4.51	90.24			
9	0.42	3.53	93.77			
10	0.30	2.53	96.31			
11	0.27	2.27	98.57			
12	0.17	1.43	100.00			
MSA: Kaiser-Meyer-Olkin Measure of Sampling Adequacy						0.71
The significance of Bartlett's Test of Sophericity						**0.00**

Table 6.11 summarises information on factors (underlying dimensions) extracted by using the principal component analysis (PCA). The PCA presents four components

with eigenvalues exceeding one, explaining a total of 67.57 per cent of variance. Factor 1, Factor 2, Factor 3, and Factor 4 account for 30 per cent, 15.58 per cent, 12.57 per cent, and 9 per cent of the variance respectively. Moreover, table 6.11 reveals that components 1, 2, and 3 explain much more of the variance than the remaining components (58.63 per cent) with component 1 contributing 30 per cent, component 2 contributing 15.58 per cent, and component 3 contributing 12.57 per cent. Thus, to ease the interpretation, it is recommended to extract three components (Pallant, 2007).

In order to understand the relationship among variables which have been clustered under these three dimensions / factors, the factors coefficient matrix is summarised in Table 6.12. It can be seen from the table that the provision of audit services by a large local audit office, rotating auditors every 5 years, providing audit services by one of the Big 4 audit firms, and the existence of an audit committee within the audited entity are classified under component 1, which contribute to enhancing and safeguarding auditor independence as perceived by OILMAs.

Table 6.12: Rotated Component Matrix

Factors Examined	Direct Oblimin Components Loading			Extraction
	Factor 1	Factor 2	Factor 3	Communality
Audit performed by large audit office	0.91			0.82
Rotating auditors every 5 years	0.90			0.80
Audit performed by Big 4 audit firm	0.87			0.76
Audit committee existence	0.72			0.57
Lack of domestic independence stds		0.84		0.70
Impact of social relationship		0.72		0.61
Non-audit services provided to audit clients		0.58		0.52
Lack of legal incentives in the audit market			0.70	0.57
High competitive audit market			0.69	0.52
Audit is performed by small audit office			0.54	0.58
One-client audit fees exceed 15%			0.46	0.52
Non-audit services provided to non-clients				0.08

Extraction Method: Principal Component Analysis. Rotation Method: Oblimin with Kaiser Normalization.

Factor 1: OILMAs' perceived auditor independence has been positively affected.
Factor 2: OILMAs' perceived auditor independence has been negatively affected.
Factor 3: OILMAs' perceived auditor independence has been negatively affected.

However, a lack of domestic independence standards, the impact of Libyan social relationships and the provision of non-audit services are classified under component 2, which are perceived to threaten and undermine auditors' independence. It can be noted that the influence of a lack of domestic independence standards is ranked

stronger than the influence of Libyan social relationships and the provision of non-audit services. Moreover, table 6.12 reveals that the third component is dominated by three variables: lack of legal incentives within the audit market, high competition within the audit market; and audit services performed by small audit offices.

6.11 ANOVA and Omega Statistics

Further, in order to determine the size effects of the selected factors as to their impact on the perceptions of respondents, one way ANOVA tests were undertaken along with omega calculations. Table 6.13 summarises the results from the ANOVA performed on the level of responses as to the effect of twelve variables on the perceptions of auditor independence. Selected variables significantly affect the perceptions of lenders, investors, owners, managers and auditors of auditor independence. It can be noted from table 6.13 that the omega statistics indicate that the most important factor among all selected ones is the lack of domestic independence standards with omega (ω^2 = 15.7 per cent). The large audit office factor records 13.8 per cent of variance.

Table 6.13: ANOVA and Omega Squared (ω^2)

Source of variance[57]	SS	df	MS	F	Sig.	ω^2
BIG4AUD	65.070	4	16.267	21.572	0.000	0.094
LRGOFC	87.893	4	21.973	32.926	0.000	0.138
FEE	20.192	4	5.048	11.552	0.000	0.050
AC	57.106	4	14.277	24.369	0.000	0.105
NAS	31.942	4	7.986	18.921	0.000	0.083
NASNC	2.615	4	0.654	3.510	0.009	0.012
ROTATE	45.422	4	11.355	16.322	0.000	0.071
LEGAL	3.467	4	0.867	2.463	0.047	0.007
LDISTD	47.048	4	11.762	38.103	0.000	0.157
COMPET	64.445	4	16.111	21.838	0.000	0.095
SMLOFC	29.704	4	7.426	22.587	0.000	0.098
SOCIAL	9.296	4	2.324	9.805	0.000	0.042
Total						0.952

[57] *BIG4AUD = Audit is performed by one of the Big 4 auditors. LRGOFC = Audit is performed by large audit office. FEE = Audit fees exceed 15% of total audit revenue. AC = Audit committee existence within audit client's company. NAS = Auditors provide non-audit services to audit client. NASNC = Auditors provide non-audit services to non-audit client. ROTATE = Rotating auditors every 5 years. LEGAL = Audit market lacks legal incentives. LDISTD = Audit market lacks domestic independence standards. COMPET = Audit service is performed within high competitive audit market. SMLOFC = Audit service is performed by small audit office. SOCIAL = Influence of social relationships.*

However, non-audit services to non-audit clients and social relationship account for the least percentage of variance. In general, omega squared results confirm that all selected variables are significant at 0.001 and 0.005 levels. Table 6.13 reveals that the total value of ω^2 at the total sample level is 0.952. In this vein, it has been argued by Peterson et al. (1985) that the small total value of omega ω^2 is to be predicted in behavioural research, and that small effect sizes are the norm, not the exception. Moreover, Table 6.1 shows that the one-sample t-test results (at the total sample level) highlight the means of the factors, which may have impacts on the auditor independence as perceived, by the 5 subject groups of this study. It should be noted that, although it can be observed from table 6.1 that there appears differences between the means of these factors, a one way ANOVA is deemed necessary to examine whether these differences are of any significance. Therefore, Table 6.13 provides the results of a one-way ANOVA and Omega squared (ω^2) so that a comparison between all means is made. More specifically, the ANOVA results confirm that there are significant differences between the means of all factors among the 5 subject groups.

6.12 Discussion

The above results highlight the perceptions of auditor independence and the perceived reliability of audited financial statements, by owners, investors, lenders, managers, and auditors. The perceptions are examined using eight main hypotheses. Firstly, H_1 assumes that OILMAs' perceptions of auditor independence are positively affected when audit services are performed by a large audit office and a Big 4 audit firm, and negatively affected when the audit service is performed by a small audit office. In terms of the audit firm size, the empirical results are in line with this hypothesis. Therefore, the results are consistent with those of other researchers (e.g. Shockley, 1981; Gul, 1991; and Awadallah, 2006), who argue that large audit firms are perceived to be more independent than small ones. However, the results are not consistent with H_{1a}.

H_{1b} assumes that OILMAs' perceive financial statements to be more reliable when audited by one of the Big 4 audit firms than when audited by a large local audit office. The results are not in line with this hypothesis and are not consistent with those results of for example, McKinley et al. (1985) and Kilcommins (1997). The results show that respondents perceive financial statements to be more reliable when audited by large

local audit offices than when audited by one of the Big 4 auditors. These findings can be attributed to the fact that Libyan users seem to be unaware of the audit quality provided by the Big 4 auditors. This may be because the Big 4 auditors have just recently entered the country, so Libyan users may not be in a position to make informed comparisons. Therefore, they may prefer large audit offices than Big 4 audit firms. In addition, Libyan users believe that large auditing companies possess human capital (competent and highly-skilled independent auditors) to a far greater degree than small auditing offices.

Secondly, H_2 assumes that OILMAs' perceptions of auditor independence are negatively affected when the audit fee, received from one client, exceeds 15 per cent of their total audit revenue. Furthermore, the results support the acceptance of H_{2a}. H_{2b} also suggests that OILMAs' perceptions of RAFS are negatively affected when an audit fee, received from one client, exceeds 15 per cent of the total audit revenue. The empirical results are consistent with this assumption. In addition, the results are consistent with those of, for example, Gul (1991) and Teoh and Lim (1996), as they argue that a larger proportion of audit fees from one audit client, in relation to the total audit revenue, impairs auditor independence. However, the current study results conflict with the statement that audit fee size has no effect on the perceived auditor independence as concluded by some researchers (e.g. DeAngelo, 1981a; and DeFond et al., 2002). Therefore, it can be observed that the views of these researchers originate from studies conducted in developed and mature auditing markets, which may be different from those emerging and developing auditing markets. Therefore, one could conclude that users from emerging economies share similar perceptions regarding the impact of audit fees. This finding can be attributable to the influence inherent in Libyan accounting and auditing practice, which is oriented towards the western models of the UK and the USA (Ahmed and Gao, 2004).

Thirdly, H_3 proposes that OILMAs' perceptions of auditor independence are negatively affected by a high level of competition within the audit environment. The empirical results are consistent with the view that high audit competition increases the risk that auditor independence may become impaired; this finding is in line with the work of several other researchers (e.g. Shockley, 1981; Awadallah, 2006). Nevertheless, they do not coincide with the results of Gul (1989), who argues that

providing audit services in a highly-competitive audit market actually enhances auditor independence. Moreover, the results are also inconsistent with those who argue that competition has no effect on the perceived auditor independence (DeAngelo, 1981a). However, the results do not support the acceptance of H_{3a}.

H_{3b} suggests that perceived RAFS are negatively affected by a high level of competition within the audit environment. The empirical results are consistent with this hypothesis that a high level of competition decreases the RAFS; this finding is in line with the results of Kilcommins (1997) which suggest that financial statements audited in a highly competitive environment were perceived to be significantly less reliable than those audited in an audit market which has low competition. However, they are not consistent with the results of Knapp (1985) which indicate that the level of audit competition does not significantly influence bank lending officers' perceptions of RAFS. Therefore, it can be concluded that the effect of competition on auditor independence and the perceived reliability of audited financial statements are different from one country to another. This means that different countries have different mechanisms according to which competition for audit clients operates.

Fourth: the hypothesis H_4 infers that OILMAs' perceptions of auditor independence are negatively affected when auditors provide non-audit services to their audit clients. The results are consistent with this hypothesis and also support the acceptance of H_{4a}. It is suggested that audit firms which provide non-audit services to audit clients are more likely to lose independence than audit firms which do not provide such services (e.g. Shockley, 1981; Canning and Gwilliam, 1999; and Joshi et al., 2007). However, the results are not in line with the perceptions of bank loan officers who indicate that they have more confidence in the independence of auditors who also supply non-audit services (Gul, 1989). Moreover, the results are also inconsistent with those of DeFond et al. (2002) who argue that the provision of non-audit services together with audit services to clients has no relation to the quality of financial reporting and the appearance of independence.

Moreover, hypothesis H_{4b} proposes that OILMAs' perceived reliability of audited financial statements is negatively affected when auditors provide non-audit services to their clients. The results are consistent with this hypothesis, and suggest that financial statements audited by auditors who provide non-audit services are less reliable than

those audited by other audit firms which are not involved in the audit. The results are in line with those of for example, Eduardo et al. (2002) and Kinney et al. (2004). However, the results are not in line with the results of Pany and Reckers (1988) which conclude that auditors who provide non-audit services '*exert little, if any, pressure on investment or lending decisions on perceived* RAFS'. Moreover, Huang, et al., (2007) suggest that there is no association between different types of non-audit service fees and biased financial reporting. These results are attributed to the view that auditors are more conservative in the post-SOX (2002) era in USA. Thus, one could maintain that although there appears to be mixed evidence regarding the effect of non-audit services, its presence seems to cause suspicions of a lack of independence and decreased reliability of audited financial statements. This study's findings are perhaps attributable to the strong Western influence on Libyan practitioners and users.

Fifth: H_5 presumes that OILMAs' perceptions of auditor independence are negatively affected by a lack of legal and institutional incentives and a lack of domestic independence standards. The empirical results are consistent with the view that strict legal incentives, such as commercial courts and official sanctions and disciplinary referrals, play a major role in regulating the audit profession in general and safeguarding auditor independence in particular (e.g. Favere-Marchesi, 2000; and Tahinakis and Mylonakis, 2005). The results also support the acceptance of H_{5a}. However, the results reflect the perceptions of users within a relatively unregulated audit market in Libya, and they express the need for legal incentives. This means that a consensus exists among the majority of users across countries, that legal incentives such as the auditor's legal liability protect auditor independence as well as the other shareholders' interests. Hypothesis H_{5b} suggests that OILMAs' perceived reliability of audited financial statements is positively affected by the existence of strict legal and institutional incentives. The empirical results are consistent with the view that the existence of strict legal incentives such as disciplinary referrals and official sanctions with strong enforcement activities increase the reliability of financial statements (Shafer et al., 1999). However, the results represent the perceptions of users and auditors within a developing and emerging audit market in Libya, and they express the need for legal incentives.

Sixth: H_6 proposes that OILMAs' perceptions of auditor independence are positively affected by the existence of an audit committee within an audited entity. The results are in line with this hypothesis and they are consistent with the findings that an audit committee's existence is perceived to reduce the audit risk and enhance audit quality (e.g. Abbott and Parker, 2000; Carcello and Neal, 2003; Joshi and Wakil, 2004; and Mangena and Tauringana, 2008). However, the results at the subgroups level do not support the acceptance of H_{6a}. Furthermore, H_{6b} suggests that OILMAs' perceived reliability of audited financial statements is positively affected by the existence of an audit committee within the audited entity. The results are inline with H_{6b} and consistent with the findings of for example, Pandit et al., (2006) and Stewart and Munro (2007) who conclude that the existence of an audit committee is believed to increase the perceived reliability of audited financial statements

However, audit committees in developing countries such as Saudi Arabia do not have the power to enhance the role of external and internal auditors nor are they able to protect shareholders (Al-Twaijry et al., 2002). Moreover, Al-Mudhaki and Joshi (2004) conclude that companies investigated had a low percentage of non executives in the audit committee, which indicates a lack of independent representation on the audit committees among Indian companies. One could argue that the regulatory requirements in developed countries such as the USA, the UK and Australia may not be applicable to emerging economies with developing accounting professions. Therefore, one could argue that the general consensus across countries regarding the importance of an audit committee in an organisation is perhaps due to the increased concern with corporate governance and auditor independence regulatory requirements following the Enron collapse and other key corporate failures.

Seventh: H_7 presumes that OILMAs' perceptions of auditor independence are positively affected by adopting the practice of rotating auditors every five years. The results are consistent with this hypothesis. The results are also consistent with the view of for example Gates et al., (2007) who conclude that audit rotation is perceived to enhance auditor independence. However, the results are inconsistent with the proposition that not rotating the audit firm is not perceived to impact on auditor independence (e.g. Shockley, 1981). Nor are they in line with those who conclude that audited financial statements are perceived as more reliable for firms with longer

auditor tenures (Kaplan and Mauldin, 2008). Moreover, the results are not in line with H_{7a}. In addition, Hypothesis H_{7b} also proposes that rotating auditors every 5 years increases the reliability of audited financial statements. The empirical results support this hypothesis. However, the results conflict with those of Ghosh and Moon (2005) who conclude that audited financial statements, and in particular reported earnings, are perceived as more reliable for firms with longer auditor tenures.

These results can be attributed to the reason that lengthy tenure between auditors and their clients (perhaps the result of extended family and tribal relationships and obligations within Libyan society) will erode auditor independence, since such long-standing relationships leads to further networking that negatively affects almost all aspects of everyday life - and auditing is no exception.

Eighth: H_8 suggests that OILMAs' perceptions of auditor independence are negatively affected by Libyan social relationships. The results are consistent with this hypothesis. The results are also in line with the proposition that national culture impacts on the accounting profession and auditor independence across countries or regions (Rutledge et al., 2003; and Ritchie and Khorwatt, 2007). The results are also in line with the perspective that culture plays a crucial role in accountants' disclosure judgment and that homogeneous accounting standards may not result in similar disclosure decisions being made across countries. Moreover, the results are consistent with those of Lord and DeZoort (2001), who argue that *'obedience to social pressure significantly increases auditors' willingness to sign-off on an account balance that is materially misstated'*.

Thus, in line with the general agreement between countries, and according to Hofstede's (1980) proposition, it can be concluded that national culture has an effect on auditor independence. The effect of national culture stems from the fact that collectivist societies seem to have difficulty in keeping or maintaining a professional distance between auditors and the other members of the community of which auditors are members, whereas individualist societies that prevail in Western countries are not characterised by close social relationships imposed by the extended family or tribe, and there is consequently much less influence from other members of the community upon auditors and their independence. Moreover, the above results are consistent with H_{8a}.

Hypothesis H_{8b} suggests that Libyan social relationships negatively affect the perceived reliability of audited financial statements. The above results are in line with this hypothesis. This finding is in line with the view that Australian respondents are less likely to assent to clients than Indian and Chinese Malaysian respondents. Therefore, Australian auditors are perceived to be more independent than those of Indian and Malaysian auditors. Thus Australian audited financial statements are perceived to be more reliable than Indian and Malaysian statements. The results are also consistent with the results of Tsakumis (2007) who concludes that Greek accountants would be less likely to disclose the existence of both contingent assets and liability than US accountants. Therefore the results suggest that country-specific culture plays a key role in accountants' disclosure judgment and that uniform accounting principles may not result in similar disclosure decision. The results also coincide with those of Askary (2006) and Patel et al. (2002).

6.13 Summary

This chapter provides statistical testing of the research hypotheses concerning the perceived auditor independence within the Libyan audit market. The examination of H_1 to H_8 reveals that all eight factors (which are discussed in chapter 3) have a significant impact on perceived auditor independence at the total sample level, while at the subgroups level, the examination of H_{1a} to H_{8a} suggests that there are differences between groups of users regarding the effects of the factors under investigation on perceived auditor independence. Furthermore, H_{1b} to H_{8b} suggest that all eight factors affect the perceived reliability of audited financial statements within the Libyan audit market. The following chapter will discuss in-depth perceived auditor independence and the perceived reliability of audited financial statements from the perspective of 16 individuals (interviewed) within the Libyan audit market.

Chapter 7

Interview Findings

7.1 Introduction

The previous chapter examined the statistical significance of the results obtained by the questionnaire survey. The current chapter presents the results from semi-structured interviews which were conducted to supplement the findings and the results of the questionnaire survey. The sample of this part of the current study comprises two owners, two investors, four lenders, three managers and five auditors. This chapter includes a profile of the interviewees. It also highlights the use and importance that interviewees attach to audited financial statements. This chapter highlights factors that lead interviewees to doubt or suspect a lack of auditor independence. The main part of the chapter is devoted to describing the effects of each of the eight factors, discussed in Chapter 3, on auditor independence as well as on the perceived reliability of audited financial statements within the Libyan audit market. The final section then concludes this chapter.

Table 7.1: Interviewees' Profiles

Age	**Under 30 yrs**	**Between 30-40 yrs**	**Between 41-50 yrs**	**Over 50 yrs**	**Total**
Owners	1	1			2
Investors		1	1		2
Lenders			1	3	4
Managers			3		3
Auditors			4	1	5
	1	2	9	4	16
Experience	**Less than 5yrs**	**6-10 yrs**	**Over 10 yrs**		**Total**
Owners		1	1		2
Investors		2			2
Lenders			4		4
Managers			3		3
Auditors		1	4		5
		4	12		16
Qualification	**CA**	**PhD**	**MSc**	**BSc**	**Total**
Owners				2	2
Investors			1	1	2
Lenders			1	3	4
Managers				3	3
Auditors	2	2	1		5
	2	2	3	9	16

7.2 Interviewees' Profiles

Table 7.1 shows that the total number of interviewees participated in the current study is 16, the majority of them (56 per cent) are aged between 41 to 50 years. The majority (75 per cent) of interviewees have over 10 years of experience in accounting and business background. Moreover, (56 per cent, N= 9) of interviewees have a university degree (BSc).

7.3 Use and Importance of Financial Statements

The frequency of using financial statements in financial decision making was not consistent across user groups. The importance of financial statements as a basis for decision making also varied across the four user groups. More specifically, investors stated that they do not rely on financial statements. Other groups such as managers, lenders and owners showed varied importance and use for financial statements for decision making. The use and importance of audited financial statements can be observed in the following scripts:

"*We can not lend money for business funding without the applicant company providing audited financial statements by a chartered accountant. The main objective of our department as a lending party is to assess the loan applicant's financial position. I believe external auditors would verify such applicants' financial statements, and based on this we make lending decisions. The other thing I would like to add is that, we normally base our decisions on the history of our customers for whom our bank manage business accounts*" (L1)[58]. "*Financial statements are required as supporting documents for borrowers. They must be verified and audited by a statutory auditor. The policy of this bank recommends that applicants' financial statements must be examined carefully. If the applicant is an existing customer, we normally have more confidence in their audited financial statements, but other lending decisions, for new not existing customers, usually go through a longer process which involves the referral to the headquarters of our bank...The senior management of the bank would decide whether to lend or not*" (L2).

"*Making lending decisions are based on three things. First is business plan the applicant proposes. Second the financial history of the applicant and third is whether*

[58] L1 = Lender No.1, L2= Lender No .2, L3 = Lender No.3 etc.

the applicant possesses a property or a building that he is willing to be possessed in case of bankruptcy. In addition to these three conditions, financial statements of the applicant must be stamped by a statutory auditor" (L3). "*It is common practice that a loan applicant, for business purposes, must submit financial statements which are approved by a statutory accountant. These audited statements assure us that the applicant's financial position is good, so we decide to lend to such an applicant. However, there are other documents we require of loan applicants to support their applications*" (L4).

Managers signified the same importance and use of financial statements for the financial decision making process. For instance, an interviewee manager states that "*the financial statements are very important documents that we must provide by law to investors and owners of the company we are responsible for. Financial statements must be checked and approved by a statutory auditor so that we can discuss its items within the annual meeting with the shareholders*" (M1)[59]. "*We use financial statements for two purposes, one for the general assembly annual meeting with the company's shareholders, and we also use them for official purposes such as for the tax authority*" (M2).

Owners expressed that they use financial statements for tax purposes and for monitoring purpose with other partners. For instance, one interviewee states that: "*I need the audited financial statements for tax authority which will not accept them without being stamped by a statutory auditor. Financial statements and original documents such as invoices are very important to monitor other partners within such a small company. Financial statements of other companies would not be normally available for the public*" (O1)[60]. "*In fact the focus is not on the financial statements but rather we as small owners pay attention to detailed transactions. The other thing is that we need audited financial statements for tax authority and for banking to get loans for our business*" (O2).

However, the investors' group proved to be not consistent with other users groups. In other words, the investors' group seemed to doubt about the validity of financial statements. For instance, an interviewee stated that: "*I am not sure about how*

[59] M1 = Manager No. 1, M2 = Manager No. 2 etc.
[60] O1 = Owner No.1, O2 = Owner No. 2 etc.

financial statements are prepared so I do not actually use them for financial decisions. Even though sometimes I attend annual meeting of the general assembly, I am not a hundred percent confident that these statements reflect the reality" (Inv1)[61]. "*My personal opinion is that financial statements are not important for me, because management has the advantage of being in contact with day-to-day business so they can manipulate the items and accounts in financial statements and they would be stamped by a statutory auditor. Though audited financial statements gain legal form after being stamped, for me they are still open to question*" (Inv2).

The above perceptions reflect the requirements of the Libyan Laws including Law 116/ 1973, LCC 1953 regarding the official use of audited financial statements. Moreover, these views are consistent with those of (Stettler, 1970). As expected and based on the results obtained by the questionnaire survey, the investors' group seem to attach less importance to financial statements; this can be linked to the results examined and presented in chapter 6, tables 6.1 & 6.2 which show the perceptions of auditor independence as held by the investors' group and other groups. Moreover, lenders, managers and owners expressed more importance to financial statements for use in the decision making process. However, across all four groups of users, these results report that there is no consensus among user groups regarding the use and importance of audited financial statements. From the above scripts, it can be concluded that investors in Libya lack confidence in financial statements, therefore they do not use them very often except for official purposes.

7.4 Prior Suspicions of a Lack of Auditor Independence

This part of the interview is aimed at gaining a general understanding about whether users and auditors themselves experienced or suspected an impairment of auditor independence. Out of 16 interviewees, only 6 interviewees (two investors, one owner, and three lenders) indicated that they previously suspected a lack of auditor independence. Further, interviewees were asked about the reasons[62] that would lead them to suspect a lack of independence.

For instance, lenders interviewed stated that: "*When financial statements are audited by a small audit office, auditors in such offices would usually try to perform their*

[61] Inv1 = Investor No1, Inv2 = Investors No. 2. etc.
[62] See tables 5.4 and 5.5 in chapter 5.

audit services but at the same time try to please their clients, specially if these clients generate income for those small auditors; for that reason, the auditor seems to me not independent " (L1). "*Small audit offices are not independent of their clients, because these small audit offices provide commercial services rather than professional. I know many sole auditors who keep their audit office stamp in their pocket and even sign and put their official stamp on financial statements which are prepared by others. Such practices speak for themselves, auditors are not independent*" (L3). "*Statutory auditors who are not full time professionals are already not independent. This is because such auditors may lack expert staff and necessary resources, so they would not be able to engage in auditing large companies. These auditors provide their services to small businesses*" (L4).

The investors interviewed pointed out that: "*Small auditors tend to rely on clients who are having good financial positions,' as a source of income. Also, in the absence of strict laws, auditors would seem to behave against the ethics of the profession*" (Inv1). "*I believe that small or large auditors are all after money, so auditors are not independent. The problem is not to do with the auditors themselves, the matter is related to procedures and legislation*" (Inv2). In addition, an owner stated that: "*It is all about fees, small audit offices seem to struggle finding audit services. I remember when I was looking for a statutory audit office to provide me with a feasibility study (required for a bank loan), I realised that audit offices offer such services at varied prices. Large offices have a standard price while small audit offices charge very cheap prices for providing a business plan. From this I can conclude that small auditors are not independent*" (O2). These view reflects the absence of effective audit regulations within the Libyan audit market and that Law 116/1973 seems inadequate.

From the above scripts, which were provided by three different groups of users namely owners, investors and lenders, it can be argued that a suspicion of a lack of auditor independence is linked or attributed to the size of the audit firm. It can also be attributed to the client company's financial condition. Thus, it can be concluded that small auditors are perceived - and appeared not to be - independent, while large auditors seem and appear to be independent in the eyes of users of audited financial statements. Therefore, financial statements audited by large auditors are perceived to be more reliable than those statements audited by small auditors. Thus it can be

concluded that these views are inline with the results of (Abu Bakar et al., 2005) The subsequent sections highlight the effects of those factors on the perceived independence and reliability of audited financial statements.

7.5 Audit Firm Size

The results obtained by interviews from different groups are consistent with those of the questionnaire survey. The majority of interviewees perceive that large audit offices and partners of Big 4 audit firms appear independent. Interviewees have more confidence in the audit report provided by large auditors. However, most interviewees believe that small audit offices appear to provide a variety of services which may include services that are irrelevant to the accounting or audit profession. This indicates that small audit offices are perceived to be not independent.

The majority of interviewees highlight a higher level of confidence in audit services performed by large audit offices and by Big 4 auditors. For instance, interviewed lenders stated that: "*there are a number of large audit offices which we trust and those have good reputations as they provide professional and independent audits to large clients including our bank*" (L2). "*Obviously large auditors have resources and expert personnel who can serve diverse clients and at the same time large auditors are concerned with their reputation which is the most important driver in the Libyan audit market. The Big 4 auditors also can serve large clients but we are unfamiliar with those audit companies. We need some years to come to form a clear picture about these international firms*" (L4).

The managers interviewed also showed similar perceptions about the size of audit firms. For instance one interviewed manager stated that: "*large audit offices do not rely on one client for their fee income, because large audit offices have many clients and have full time staff who perform audit services to clients. But small auditors who have a mobile office (they keep documents and official stamps in their car) rely on specific clients for generating economic income, thus they appear not to be independent*" (M1).

In addition to the above users interviewed, auditors also expressed high confidence in the large audit office and Big 4 auditors. For instance, a partner at one of the Big 4 audit firms stated that:

"I believe large audit firms are independent because the selection and appointment of such auditors is arranged at the highest level (general assembly of an entity or shareholders). Thus auditors are also independent when scrutinising a company's financial statements... a large audit firm aims to protect its reputation and avoid litigations so we can conclude that auditors from big audit firms are objective and free from the influence of audited entity's management... Adding to this, big audit firms have the advantage of possessing human capacity including expertise and skilled and specialised personnel" (4A1)[63].

"Large audit firms or big audit offices are able to provide diverse audit services to different businesses, therefore auditors within these audit firms are more independent and normally are not influenced by their clients; this is due to fear of losing social and professional reputation among the colleagues of the profession" (A2)[64].

From the above outline regarding the effect of audit firm size on perceived auditor independence, it can be stated that there is a general consensus among the interviewees that large audit offices are more independent than small local auditors. These views support the views of Gul (1991) and Awadallah (2006). However, one lender interviewed (L4) showed more confidence in large local audit offices than in the Big 4 audit firms; the reason being because users in Libya seem unfamiliar with the Big 4 auditors who recently entered the small Libyan audit market. Moreover, the entrance of the Big 4 auditors to Libya has created a competitive audit market where local auditors find it difficult to survive (Derwish et al., 2004)

7.6 Audit Fee

When asked to interpret the impact of high audit fees (one-client audit fees exceed 15 per cent of gross audit revenue) on the auditor's independence, an interviewed auditor stated that: *"I think it is important that we take into account the size of audited entity... we also need to see different years and compare with relatively similar entities so we can decide whether high audit fees would impair auditor independence.....receiving audit fees in full gives an indication of an independent auditor.....real audit fees disclosure also shows auditor independence...this again can be maintained by the process and mechanism of an auditor appointment which should be delegated to*

[63] A41 = a Big 4 audit partner operating in Tripoli- Libya.
[64] A1 = Auditor No.1 , A2 = Auditor No. 2 etc.

general assembly, I mean the auditor must be appointed by the highest authority of audited entity (such as shareholders) not management, which runs and uses the entity's resources...auditors who are unable to assess the price of their audit effort, I consider them as not professionals... in short one-client audit fees exceed 15 per cent of the total audit revenue do not affect auditor independence" (A1).

An auditor who is a partner at one of the Big 4 auditors, when interviewed, stated that: "*the 15 per cent limit would not affect the independence of an auditor as long as these auditors are working for large audit firms such as our audit firm. We as auditors work according to very tough procedures and high professional standards*" (4A1). It can be noted that the auditing practice and procedures of the Big 4 auditors would spread in the Libyan audit market and thus develop the auditing practice in the Libyan environment. For instance CBL (2005) introduced IASs in the Banking Law 1. Moreover, most entities in Libya apply IFRS (Deloitte 2009).

A relatively similar view was obtained from an interviewed lender who said that: "*I would not consider high audit fees as a threat to an auditor's independence, when there are adequate regulatory requirements regarding an auditor's liability and audit fee disclosure... but if the audit work volume is not relatively equivalent to audit fees, this would lead us to question the auditor independence*" (L3).

However, one manager interviewed stated that: "*the most important issue is the disclosure of audit fees, because publication of audit fees would usually comprise unpaid audit fees which may lead to a conclusion that auditors may lose their independence. In addition, when one-client audit fees exceed 15 per cent of total audit income, there would be a doubt about auditor independence. This is because such a client would make auditors rely on them for economic income therefore, auditors try not to lose such a client*" (M2). This view mirrors the requirements of the (APB 2004) regarding the maximum level of one-client audit fees.

7.7 Competition in Audit Market

The results of the questionnaire survey are in line with the results obtained by the interviews. Interviewees provided diverse views regarding the competition in the audit market and its effect on auditor independence. Interviewed lenders, when asked about the effect of competition in the audit market on auditor independence, stated

that: "*higher levels of competition damage the audit profession in that small auditors tender low prices and get closer to clients so that auditors are ready for clients' wishes even if these wishes are at the expense of the ethical and professional standards*" (L2). "*Audit market competition nowadays is very high because small auditors struggle to find audit clients, therefore, they compete with other smaller auditors so they charge low audit fees and no matter what the audit work volume is*" (L3). These views are supporting the results of Shockley (1981) and Kilcommins (1997).

However, when an auditor was asked about competition, he provided an interesting script as follows: "*I consider competition as an important element that enhances the independence of the auditor. This is because the audit environment is subject to accounting and auditing principles and technical procedures that distinguish the accounting and auditing services from other general services which are sold in markets….focusing on reputation and professionalism and high audit quality is the driver for competition….therefore, companies have more options to select from such audit environments… but if you talk about the material side or economic point of view, basically, I would not consider the audit as a profession*" (A1).

"*High audit competition in Libya can be interpreted as low demand for audit services plus limited local audit offices….despite the work scarcity, we do not go after clients. Clients approach us because we have full time personnel with high skills…. Other small audit offices or sole auditors have only a licence and bag. Such auditors accept audit work with very low price which does not even correspond with the audit work volume…though I can not confirm whether such auditors compromise their objectivity and independence in light of low audit prices*" (4A1).

"*There is no competition in Libya, but rather there is a network of relationships… local audit offices who have got powerful and key officers in the government, those only who can get more audit work which is delegated by unclear mechanism involving the delegation by government to audit certain stat-owned entities. In such cases I would assume and say that such practices are absolutely unethical*" (A2). These views indicate to the limited role of the LAAA in developing the auditing practice in Libya. Thus, it could be argued that Law 116/1973 is insufficient. Moreover "*There are two extremes related to the audit market competition. One extreme is that auditors*

compete for having audit clients even when they undermine the price of their audit work so that the price would be not equivalent to the volume of audit work or the effort needed to provide this work. The other extreme is that there are auditors who care about their reputation and always comply with the ethics of the audit profession" (A3).

7.8 Non-Audit Services

The majority of interviewees perceived that when auditors provide non-audit services they would lose their independence. When lenders were interviewed, one stated that: "*the auditors are more concerned with non-audit services than the audit work because non-audit services are more profitable and yield higher levels of income, thus auditors who offer non-audit services appear not independent in my opinion*"(L3). "*I think regulators in Libya must distinguish between auditors and non-auditors according to non-audit and audit work; I wanted to say that auditors must not provide other services than external audit scrutiny, otherwise auditors who supply non-audit services to their audit client will never be independent, this is because non-audit services involve high fees that auditors can not resist*" (L4).

Similar to the above view an auditor interviewed stated that: "*It is important that professional bodies or related parties separate scrutiny and audit work from management consultation services including preparation of accounts, accounting system design and other non-audit services... for example in the Libyan environment, chartered accountants prepare financial statements for some companies which lack skilled accountants and personnel...and then those chartered accountants submit their report as auditors of these financial statements which previously have been prepared by them ....in such cases there must be a separation between non-audit services and pure audit which includes financial statements investigation. In such cases we can detect that there are inadequate regulatory requirements which may prohibit such practice*" (A1).

An audit partner who works for a Big 4 audit firm stated that: "*Big 4 auditors and those large firms which are listed in US Stock Markets such as our audit firm are not permitted to be a book keeper and an auditor at the same time...our audit firm classifies those two services into two channels; Channel 1 is audit and Channel 2 is advisory...for example we provided advisory and non-audit services to the French*

bank Société Générale and thus we can not audit this bank" (4A1). Thus, it can be observed that Big 4 audit firms in Libya comply with the SOX (2002) Act which prohibits the provision of non-audit services to audit clients.

Another auditor interviewed stated that "*first of all and regrettably, there are many audit offices which provide non-audit services to the extent that they become general services providers.... Those audit offices provide services which include the registration of foreign companies, pay legal and tax fees on behalf of foreign companies against non-audit fees...such audit offices interpret audit reports and other operational reports from English to Arabic. This is in order to help foreign companies use such reports with local and official government parties so these auditors can not be independent nor do they belong to the audit profession" (A2).* This view is consistent with the argument that the accounting profession in Libya is open to whoever wants to practice it, because LAAA membership does not require any effort such as to pass any particular exam (Derwish et al 2004).

Interviewed investors agreed with the above views regarding the effect of non-audit services on auditor independence. For instance, one investor stated that: "*Non-audit services or management and accounting advice are required by management of audited entity, and the majority of non-audit services are to help managers in technical accounting issues, and since we as shareholders are away from what is going on in the company, I believe the auditors are not independent from the management because management pays the fees for those auditors therefore, a manipulation can occur in that, managers will exercise their power on the auditor so that managers get what they look for*" (Inv2). This view confirms that Law 116/ 1973 does not prohibit auditors from providing any non-audit services to their clients in the country.

However, contrary to the above, one manager interviewed stated that: "*the provision of non-audit services tend to supply technical and financial advice to a variety of large clients, at the same time auditors fear litigation costs if they get caught liable for any misconduct or any behaviour that may violate the ethics of the accounting profession. Therefore, I think providing non-audit service to audit clients would not impair auditor independence*" (M2).

7.9 Legal Incentives

The results obtained from interviews, regarding the effect of legal incentives on auditor independence, are consistent with those results of the questionnaire survey. When interviewees were asked about the influence of legal and institutional incentives which may safeguard auditor independence, the majority perceived that these incentives are very important elements in enhancing independence and protecting the audit profession. For instance, an interviewed auditor stated that:

"*The Libyan audit environment lacks proper regulation.. for instance auditor liability is not clearly regulated and it lacks specific articles in a specific code... generally speaking, independence of auditors in Libya is considered to be weak when compared to those of developed countries like the USA and UK.. but if we compare it with those less developed African nations we would find it much better... having such a level of auditor independence in Libya can be attributed to the failure of Law 116 in developing the audit profession in the country... In general, auditing in Libya lacks regulatory requirements including codes, guidelines and legal imperatives*" (A1).

"*In this occasion I would like to provide you with a real example which highlights a legislative mistake in one of the Libyan laws. There is an article within one of the Libyan laws which states that an "audit must be conducted in accordance with the accounting principles and procedures...Producing and enacting such errors within legislative requirements indicates the lack of experts and skilled personnel; the LAAA on the other hand, lacks the resources and power to act and develop the audit profession in Libya...the instability of institutional structure in Libya is a major obstacle in developing the profession...no training.. no professional rehabilitation*" (A2). These views highlight a lack of legal incentives within the Libyan audit market and that after more than three decades Law 116/1973 and LAAA have been unsuccessful to develop the auditing practice in Libya.

An audit partner who works for a Big 4 audit firm stated that: "*according to our firm's policy, we are not allowed to audit a company in which we own shares.....We either withdraw our shares or do not provide the audit service to this company.... but according to the Libyan Law there are no specific regulatory guidelines that may prohibit providing non-audit services and audit services to the same client...I also can confirm that we have to fill in forms on which we confirm and agree that we do not*

accept gifts from clients, we also confirm that we as partners do not have family-relationships with these clients.. Although Libyan audit regulation is weak and inadequate, our policy plays a good role in achieving independence and high audit quality" (4A1).

"*Regarding the regulatory requirements including local or domestic standards, my personal opinion is that accounting and auditing in Libya is not in need of specific and private standards...Because standards are created for solving some problems that occur within the accounting treatments which are driven by complex business activities, both commercial and services. But in Libya there are no complex transactions which may lead to controversial debate so that it may result in a departure from the generally accepted accounting principles.....though in the future and as a result of the growth of private businesses in the country we may see a growth and development in the profession*" (A3).

"*In terms of auditor's liability, Banking Law 1/2005 is the only one which states and imposes fines and allegation costs against auditors if caught responsible for breaching or violating the relevant laws... though these laws are still not precise and flexible. My opinion is that the problem is lack of enforcement of laws not lack of laws*" (A4).

It addition to the views of the auditors interviewed, lenders expressed similar views. For instance, "*although our Libyan audit environment lacks proper audit regulation, audit profession should be practised.....but accounting knowledge which auditors gain provides a kind of professional objectivity and independence... if such skills and knowledge are absent, there would not be an audit profession at all*" (L1).

"*Since the audit profession and accounting in general are still in the developing stages, the audit regulatory requirements should require a mandate publication for all frauds and misrepresentations or any resources misused, so that such publicity raises awareness among accountants, auditors and users*" (L2).

In addition, another lender stated that "*Libyan audit market needs active enforcement of legislations that would restrict auditors from violating the standards of profession*" (L4). These views are consistent with those of Wahdan et al. (2005) and Samsonova (2006).

7.10 Audit Committee

It should be noted that most countries require the establishment of an audit committee within their regulatory requirements in order to enhance corporate governance. In this respect, the majority of interviewees have more confidence in the audit committee's existence within an audited entity. Interviewed auditors stated that:

"*The existence of an audit committee within an audited entity very much enhances the objectivity of auditors.... Audit committees would oversee any weaknesses or any issues that raise question marks regarding the process of audit and scrutiny of financial statements and the entity's books and accounts...However, within the Libyan environment, there is a lack of audit committees...and in this area the activities of the LAAA is limited except for IFA*[65] *which tries to introduce and activate such audit committees in the country*" (A1).

"*We do not have the term audit committee in Libya, but there is a control committee which may follow up the financial performance of an entity and oversee the audit work*" (A2).

In the same regard, another auditor stated that: *There is no audit committee as such, but there is an overseeing committee which I think is different from an audit committee. In Libya, we do not have auditing standards. Audit is only conducted and required by law. But generally speaking, an audit committee is an important element of good corporate governance which may safeguard an auditor's independence*" (4A1). These views are inline with the results of Carcello and Neal (2003) and Stewart and Munro (2007).

"*Audit committee in this context is substituted by the work of control committee according to Libyan Commercial Code [LCC]. One of these codes in LCC articles requires the formation of a control committee which may take the role of an audit committee. For instance, the control committee members should be elected from owners and shareholders and then the control committee can appoint the auditors to audit the company's financial statements...but the reality on the ground is sometimes*

[65] Institute of Financial Auditing, which is a state-affiliated oversight body that audits the state-owned entities IFA (2007).

not in line with the requirements of the Libyan Commercial Code. The reason is that the majority of such companies are state-owned entities" (A3).

However, and as predicted when an investor was interviewed: "*audit committees or any other control committee seems to me part of management because in Libya there is no clear or specified mechanism by which such a committee can be appointed, therefore, these committees will add nothing to the auditor independence*" (Inv2). This view mirrors the results of Al-Twaijri et al. (2002) and Al-Mudhaki and Joshi (2004).

From the above insights regarding the benefits that audit committees (control committees) may provide in safeguarding auditor independence, it can be concluded that interviewed groups are not consistent in their views concerning the audit committee. In other words, the investors interviewed showed no confidence in the audit committee role in safeguarding auditor independence. One could presume that was because an audit committee in Libya does not exist under the term audit committee but rather is known as an overseeing committee.

7.11 Rotation of Auditors

When interviewees were asked about the rotation of the auditor after a certain period of time, the interviewees provided different views about the benefits of rotating auditors every 5 years. For instance, one auditor stated that: "*rotating auditors would have no effect on the auditor independence. This is because auditors from large audit firms are not vulnerable to client's pressure as they may be threatened from replacement. In other words, since auditors are complying with the requirements of an independent audit, they would appear independent and keeping the distance between themselves and their client's management... having a fixed tenure period for example a 5-year tenure in rotating small auditors would be useful*" (A1). However another auditor provided a contrary view by saying that: "*as far as I know, there is no specific legislation that may require rotating auditors or specific audit tenure in Libya, therefore, rotating an auditor seems not relevant*" (4A1).

In addition to the above views, one lender interviewed stated that "*regardless of the required rotation, the audited entity organisation system is more important in maintaining high audit quality. In other words, companies which have guidelines that*

require auditors to be appointed by the shareholders, appear to help maintain an independent audit. Once again I think the audited entity's organising system, which oversees the appointment of auditors, is more important than rotation" (L2).

However, an owner stated that: "*rotating auditors every 5 years would prevent auditors from forming close relations. These relationships make auditors and clients violate auditing standards and therefore auditors would appear not independent, therefore rotating is very important in such circumstances to enhance independence*" (O2). These views support the results of Gates at al. (2007). It can be noted that, although Libyan Law 116/ 1973 does not require specific audit tenure, it seems to be a good practice when rotating auditors after 5 years.

7.12 Libyan Social Relationships

The results highlighted by interviewees regarding the influence of social relationships in a small society such as Libya, can be outlined in the following scripts. For instance one interviewee said: "*regarding degree of family relationship, until the fourth degree auditor should not get involved in audit work where he would be in contact with those relatives...beyond such degrees I consider the auditor to some extent as an independent and objective person... but the problem is the Libyan audit environment lacks domestic auditing standards which may treat any consequences of our societal structure such as friendships and tribal loyalty which are definitely affecting every thing in the country including auditor's work....LAAA is blamed for not taking action in this regard*" (A1).

"*Social relationships to some extent affect and undermine auditors' independence within the Libyan audit context...this is because our society is small and social relationships are easily built, which affect all aspects of everyday life*" (A3). Moreover, "*although there is no clear guidance in relation to social relationships and auditors, the tradition is that auditors, who have family-relationship within an entity which is to be an audit client, are not permitted to scrutinise or audit such entities*" (A4).

"*I can confirm that social relationships only affect the audit work process... not auditors' independence....From my experience and as a result of our societal structure, we normally meet, in social events, with clients and develop societal*

commitment so that we, as auditors, do not want to make clients unhappy if there are signs of irregularities in the client's accounts.. What we do is try to give them room and time to correct and amend their accounts...but if these clients continue and determine not to cooperate....We never compromise our independence...The other important thing is that...I do not want to be legally liable or responsible for collaborating with clients and accepting their wishes on the account of our objectivity... What makes the burden of liability heavier is the Internal Review that we adopt" (4A1). Interviewed lenders added the following by saying that: "*social relationships and networks are important in getting audit clients, so auditors who have power and extended relationships appear to me as not independent from their clients*" (L2). These viewpoints are consistent with the results of Patel at al. (2002), Askary (2006) and Ritchie and Khorwatt (2007).

7.13 Reliability of Audited Financial Statements

Interview results regarding the perceived reliability of audited financial statements are outlined below. For instance, a Big 4 partner states that: "*I consider the financial statements which are scrutinised by us or other Big 4 auditors more reliable...I also think local auditors add credibility to financial statements they audit. However, there are exceptional cases where auditors may not comply to the ethics of the profession*" (4A1). This view is inline with the results of Kilcommins (1997).

Another auditor added that: "*flexible laws and lack of local audit standards have resulted in that the majority of foreign companies, which operate in the country, to represent losses over ten years successively and that local audit offices provide clean audit reports... This therefore enables these companies to evade huge amounts of taxes.... I would say that local audit offices collaborate with foreign companies and help them avoid paying the correct amount of tax...the only one thing is that the tax authority estimates the net income on which taxes are calculated...from this example, you can tell whether or not these audited financial statements are reliable*" (A2). This statement draws attention to the lack of enforcement activities within the Libyan audit market. Furthermore, this is consistent with the results of Awadallah (2006).

Moreover, "*Ordinary users in general are not aware of the importance of audited financial statements or the importance of auditor independence...such users can not identify whether or not an auditor is independent...the real example about this is that*

a financial dispute resulted from management breaches occurred within one of the private banks, and the Central Bank of Libya formed a committee to investigate the problem and to re-elect a new board of directors...despite the breaches of the previous board, shareholders re-elected this board of directors.. This example indicates the lack of awareness among those shareholders" (A3).

"*My opinion is that audited financial statements and audit reports are considered official documents which are required by law for the purpose of raising funds... I think this is because all are state-owned entities, those who claim funds and those who provide them*" (Inv1).

"*Financial statements are mostly not prepared for large state-owned companies in the country. For instance now in 2008, the company XY*[66] *is still struggling to finalise the financial statements of 2002..Thus I can assume that financial statements are not that important... but recently and as a result of the growth of the private sectors, we can notice the importance of audited financial statements for the private sector*" (L1).

"*The banking sector is the most dominant party that provides up-to-date audited financial statements... This is because most banks are now listed in the newly established Libyan stock market.... Financial statements of banks are more reliable than other sectors... this is at the institutional level...But individuals are still not aware of the importance of financial statements in making their business decisions*" (L2). In addition to this statement, the Banking Law 1 (2005) seems to add credibility to financial statements after the introduction of IASs in the banking sector in Libya.

"*It is apparent that large audit offices provide audit and non-audit services to clients, but only those audit offices which have political power can gain audit work and delegation from state-owned companies to audit their financial statements. However, these auditors collaborate and help their clients present losses over successive years so covering any misuse of resources. In short, auditors and managers of those companies cooperate to maximise their own wealth...thus I would say these audited financial statements are only official documents and will be used by government officials*" (L4).

[66] For anonymity, the interviewee requested not to put the name of this company in the script though he named it.

7.14 Audit Dispute

This part of interview involved the questioning auditors and managers about potential sources of dispute which may occur between them. Auditors were asked whether they have / had a dispute between them and their client managers. For instance, an audit partner at a Big 4 audit firm stated that: "W*e honestly do not rely on one client, we have diverse clients, and therefore we do not compromise and give in to any client in case of conflict, we follow the methodology of logical dialogue about the audit work and mostly we reach an agreement which is satisfying to us and maintains our principal aim of objectivity and meeting auditing standards...including independence of course*" (4A1).

"*Conflict and disputes are a part of audit work because of flexible accounting treatments, but at the end of the day we come to a conclusion and we agree on logical foundation. However, if conflict is about serious violation I would not put my reputation at risk nor am I willing to be liable for others' misconduct*" (A2).

"*Most conflicts I experienced are about the accounting treatments which are related to intangible assets, this appears to me only due to lack of expertise and shortage of well-educated accounting staff in companies. But in the last part we reach an agreement based on proper treatments in accordance with accounting and auditing standards*" (A4).

Managers were questioned on whether they experienced conflict with their auditors. One manager said: "*I had a conflict with a statutory auditor about the time table that we agreed to meet as a deadline, but later we reached an agreement and things had been solved*" (M2). The other interviewed manager stated that: "*the conflict was due to improper accounting treatment which later was corrected and agreed upon*" (M3). These statements are consistent with those results of Awadallah (2006). However, the absence of legal incentives and lack of enforcement activities in the country would make auditors to be exposed to audit disagreement and that auditors are easily replaced for unjustified reasons.

7.15 Summary

This chapter presents the findings of the interviews conducted amongst 16 individuals (2 owners, 2 investors, 4 lenders, 3 managers and 5 auditors). The results obtained by

the interviews are consistent with those results reported by the questionnaire survey. The majority of interviewees use and attach higher levels of importance to the audited financial statements. The main part of the interview was aimed at getting further insight about the eight factors as reported in the questionnaire survey. The majority of interviewees perceived that larger auditors are more independent than smaller ones; higher audit fees would lead smaller auditors to lose their independence; competition within the audit market was also perceived to impair auditor independence; the provision of NAS was also believed to threaten auditor independence, and social relationships among Libyan society is also perceived to influence auditor independence.

The majority of interviewees on the other hand, perceived the strategies which may safeguard auditor independence to be very important. For instance, strict legislations, the existence of an audit committee (control committee) and the rotation of auditors are perceived to enhance auditors' independence. The interview results also reveal that most interviewees perceived auditor independence as a critical issue in that an independent audit leads to an increased reliability of audited financial statements. In addition, it can be concluded that the interview results reinforce the questionnaire results. The following chapter concludes this thesis.

Chapter 8

Conclusion

8.1 Summary

This study investigates the perception of auditor independence and its significance in maintaining public confidence in audited accounting information for decision making. Within the agency theory context, this thesis aimed to study the perceptions of auditor independence within a developing country (Libya). The Libyan audit market is where the subject-groups of users of financial statements operate. This country has witnessed an economic reform and development during the last five years or so and as a consequence, a development of the accounting and audit profession is highlighted. This study also highlights the Western influence of US and UK accounting practices, on the accounting in Libya, which were conveyed to the country after the discovery of oil in the late 1950s when American and British oil firms invested in the exploration and production of oil in Libya. Although the accounting profession in this country complies with the GAAP, there are no formal standards that may be adhered to. Moreover, it can be concluded that the absence of a standardised form and content of financial statements in Libya has led to the emergence of different forms of financial statements, even those within the same industry (Ahmad and Gao, 2004).

This study discusses the concept and nature of auditor independence. It also discusses the agency theory which is underpinning this research. Within the context of the agency theory, an independent auditor is expected to play a significant role in minimising the agency costs. More specifically, an auditor is appointed to verify the financial statements which were prepared by management (on behalf of owners). However, such an appointment would represent further agency relationship between auditors and their appointing party (Watts and Zimmerman, 1986). If auditors are hired by owners or shareholders, an independent audit in appearance would be observed. Nevertheless, the appointment of external auditors for large companies, which comprise large and diverse shareholders, is normally in the hands of the management of such companies.

Managers (agents) are delegated to perform and run the business on behalf of the owners of these businesses that provide capital and resources; this delegation represents the agency relationship that involves agency costs (agents' payments and remunerations). Practically, owners/ shareholders would not be able to access the accounting information of the day-to-day operations of their business (Lee (1972). Therefore, managers are expected to maximise the shareholders' wealth. However, managers also seek to maximise their own wealth. In that instance, a conflict of interest exists between the agents and the principal. In order to mitigate this agency problem, auditors are appointed to monitor the agency relationship. Similarly, the appointment of auditors represents further agency relationship between auditors and the management of audited companies. Thus, in order for the agency relationship to function properly, an independent auditor is expected to monitor this agency relationship. On the other hand, audit committees monitor auditors' independence by maintaining proper relationship with their clients. However, due to the fact that auditors themselves may get closer to their clients, they compromise their independence due to the existence of several factors (economic, regulatory and cultural factors) which may be perceived to affect the independent audit and the perceived reliability of audited financial statements.

This research, therefore, examines auditor independence and the perceived reliability of audited financial statements as perceived by five major groups of users including owners of companies with unlimited liability, investors within limited liability companies, corporate lenders of commercial banks, managers and external auditors within the Libyan audit market. This thesis provides a descriptive analysis of the data collected by the questionnaire survey. It also sheds light on the factors that affect the perceived independence and the perceived reliability of audited financial statements. Furthermore, this study examines the significance of the impact of the factors on the perceived independence and the perceived reliability of audited financial statements. This study also highlights further insights obtained by interviews, which reinforce the results obtained by the questionnaire.

The descriptive analysis provided evidence implying that Libyan users consider auditor independence as a crucial element in the accounting profession. In particular, the results are supportive of the view of Mautz and Sharaf (1961) that an independent

audit is perceived to produce reliable accounting information which is contained in the financial statements. The results also highlight the importance and use of financial statements by Libyan users in making their lending and / or investment decisions and the importance they attach to the audit report which combines the financial statements. These results suggest that Libyan users consider financial statements and the auditor report to be important accounting information in forming business decisions. These results are consistent with the view of Moizer (1991). Furthermore, the descriptive analysis sheds light on the audit disputes and the reasons that may lead to audit disputes, suggesting that discovering unrecorded transactions which may have material impact and switching between accounting rules are the most important reasons that may cause an audit dispute between auditors and their clients.

In order to fulfil the objectives of this research, eight main hypotheses were examined. First: the results of the current research support the acceptance of the assumption that perceived auditor independence is positively enhanced by large audit firm size. This is in line with the view of Shockley (1981), Gul (1991) and Awadallah (2006). In addition, the results show that there is no consensus among OILMAs regarding the impact of audit firm size. However, the results of the nonparametric tests indicate that the subjects of this study consider financial statements to be more reliable when audited by large local auditors than when audited by one of the Big 4 auditors in Libya. This view is inconsistent with those of McKinley et al. (1985) and Kilcommins (1997) which might be due to an unawareness of Libyan users of the Big 4 auditors' existence in the Libyan market.

Second: the results of this research indicate that OILMAs perceived that when one-client audit fees exceed 15 per cent of the total audit revenue, the independence of the auditor of this client may be impaired. Furthermore, the findings of this research demonstrate that there is a general agreement among OILMAs regarding the negative effect of high audit fees received from one client which may create an economic dependence on the client by the auditor. In addition, the results indicate that when one-client audit fees are greater than 15 per cent of the gross audit, OILMAs perceived the client's financial statements to be less reliable. These views are in line with the view of Teoh and Lim (1996), but inconsistent with those of DeAngelo (1981a) and DeFond et al. (2002).

Third: the results of this study show that high competition in the audit market is negatively affecting the OILMAs' perceived auditor independence. This view is in line with the results of Shockley (1981) and Awadallah (2006) but not in line with the position of Gul (1989). However, the results indicate that there is no consensus among OILMAs' perceptions regarding the negative effect of competition in the audit market on perceived auditor independence. In addition, the results demonstrate that financial statements audited in a highly competitive audit market are perceived to be less reliable than those audited in audit market with lower competition. This corresponds with the results of Kilcommins (1997) but not with those of Knapp (1985).

Fourth: this study results show that the provision of non-audit services impairs the perceptions of auditor independence. Moreover, the results also indicate that there is a consensus among OILMAs regarding the negative impact of the provision of non-audit services by the auditors to their audit clients. This supports the views of Canning and Gwilliam (1999) and Joshi et al. (2007). Moreover, the results demonstrate that the provision of non-audit services along with audit services is perceived to decrease reliability of audited financial statements. This view reinforces the results of Eduardo et al. (2002) and Kinney et al. (2004) and conflicts with those of Pany and Reckers (1988).

Fifth: this research results demonstrate that weak legal incentives and a lack of domestic independence standards in the Libyan audit market impair the perceptions of OILMAs towards the auditor's independence. Furthermore, the results at the subgroups level indicate that there is a consensus among the users regarding the effect of unavailability of legal incentives and domestic independence standards. In addition, the results indicate that when an audit market lacks legal incentives, OILMAs perceived that audited financial statements are decreased. These perspectives support the views of Shafer (1999), Favere-Marchesi (2000) and Tahinakis and Mylonakis (2005).

Sixth: the results of this study show that the existence of an audit committee play a key role in monitoring and enhancing perceived auditor independence in the Libyan audit market. However, the results reveal that there is no consensus among OILMAs regarding the impact of audit committee existence in the audited entity, indicating that

the investors' group perceived that an audit committee has no role to play in safeguarding the independence of the audit. This may indicate a lack of awareness of the audit committee's role. This is due to the fact that in Libya, there are no audit committees as such within corporations, but rather there are control committees with different functions. Furthermore, the results confirm that having an audit committee within an audit client's company is perceived to increase reliability of this company's audited financial statements. The consensus is that the audit committee plays a significant role in maintaining an independent audit (Abbott and Parker, 2000; Carcello and Neal, 2003; Joshi and Wakil, 2004, Pandit et al., 2006; Stewart and Munro, 2007 and Mangena and Tauringana, 2008).

Seventh: the results of this research conclude that rotating auditors every five years is perceived to enhance and safeguard the appearance of auditor independence at the total sample level. However, performing t-tests at each subgroup reveals that there is no consensus among OILMAs' perceptions regarding the impact of 5-year auditor rotation. For instance, the investors' group perceived that a 5-year auditor rotation has no effect on the perceived independence of auditors. Moreover, the results of this research reveal that rotating auditors at three levels (audit firm, audit partner and audit manager level) increases the perceived reliability of audited financial statements. They support the position of Gates et al. (2007) but are not in line with the view of Kaplan and Mauldin (2008).

Eighth: the findings of this study suggest that social relationships that embody the characteristics of Libyan society, impair the perceptions of auditor independence. Moreover, the results support the statement that there is a consensus among OILMAs regarding the negative impact of Libyan social relationships on perceived auditor independence. These results support the view that Libyan social relationships, extended family and tribes threaten the independence of auditors Ritchie and Khorwatt (2007). Furthermore, the results also support the assertion that the social relationships which are embedded in Libyan society (a collectivistic community) decreases the reliability of audited financial statements.

However, despite the fact that the Libyan culture represents significant differences between Libya and other developed countries such as the UK and the USA, the results of this study suggest that such differences in context may not mean that the perceived

auditor independence and the perceived reliability of audited financial statements are different across countries. This study findings which are consistent with the results of (e.g. Firth, 1980; Firth, 1981; Mangena and Tauringana, 2008) in the UK and inline with (e.g. Pany and Reckers, 1980; Shockley, 1981; Shafer et al., 1999; Carcello and Neal, 2003; Jennings et al., 2008) in the USA support the conclusion that the accounting and auditing practices are alike, while the countries' underlying cultures are diverse Patel and Psaros (2000).

This can be attributed to the reason that the development of accounting and auditing systems in developing countries (Libyan is no exception) has been strongly influenced by the practices and standards of the developed countries such as those of the USA and the UK. In this regard, it has been argued that the current Libyan accounting education system and accounting profession are oriented toward the accounting environment and the private sector of the UK and USA Ahmed and Gao (2004, p.387).

Factor analysis was also employed in order to examine the interrelationship among the factors under investigation. The results of factor analysis highlight three main groups of variables which share similar characteristics. Factor 1 represents those variables which are perceived to enhance the perceptions of auditor independence. These variables are: an audit performed by a large audit office, rotating auditors every 5 years, an audit performed by one of the Big 4 auditors and an audit committee within the audited entity. Factor 2 highlights three variables which are perceived to impair auditor independence, which are namely: a lack of domestic independence standards, Libyan social relationships and providing non-audit services. Factor 3 represents a lack of legal incentives, high competition in the audit market and small audit offices, which are perceived to impair the independent audit in the Libyan audit market.

Moreover, ANOVA and Omega statistics (ω^2) were also utilised in order to identify the most influential factor(s) affecting auditor independence at the total sample level. Omega squared is used to measure the effect size of these factors under examination. The results of omega squared indicate that the lack of domestic independence standards is the strongest variable amongst all other variables under investigation representing 15.7 per cent of variance at a significance level of $P = 0.000$. It can be

argued that the perceptions of OILMAs regarding the effect of the absence of Libyan independence standards indicate the perceived and the expected benefit of local independence standards, which may serve the local needs of users of accounting information.

It can be concluded that the majority of interviewees use and attach higher levels of importance to the audited financial statements. Interviewees also perceived that larger auditors are more independent than smaller ones. They also perceived that higher audit fees from one client would lead smaller auditors to compromise their independence, as small auditors are perceived to be economically dependent on one major client for generating income. Interviewees also perceived high competition in the audit market impairs auditors' independence, especially small auditors within an unregulated audit market. Moreover, there is a consensus among interviewees that the provision of non-audit services impairs the independence of an audit. Interviewees also perceived that social relationships rooted in the Libyan society impair the independence of an audit. Furthermore, interviewees perceived that strict legislations and active enforcement, audit committees (control committees) and rotating auditors enhance and safeguard the independent audit which result in an increase in the reliability of audited financial statements. These interview results reinforce the results of the questionnaire survey, therefore, it can be concluded that this research instrument produces a valid and reliable data.

8.2 Contribution

Once the above objectives have been achieved, this study might contribute to the existing literature of auditing in general and auditor independence in particular, in different ways. Firstly, this study research examines the issue of auditor independence and the perceived reliability of audited financial statements within a developing audit market in Libya for the first time. This study would add to the limited research in the area of developing countries. Secondly, this study aims to reduce the gap in auditor independence literature, which is mostly generated within developed and Anglo American countries. The bulk of this research focuses on the economic and regulatory factors that are perceived to have an impact on auditor independence.

However, the influence of country-specific culture has been neglected. Thus the study of auditor independence within a global context reduces this gap by providing evidence that suggests different countries and societies have different national cultures which can be linked to the accounting systems of different countries, therefore national culture influences auditor independence and the quality of audited accounting information. In other words, based on Hofstede's (1980) theory, and Gray's (1988) model and Salter and Niswander (1995), Libyan society is characterised as a collectivistic society where auditors belong to a network of extended families and tribes. Auditors in such a society face difficulty in maintaining their independence, therefore the outcome is less reliable accounting information. This conclusion is consistent with the results of Lord and DeZoort (2001), Patel et al. (2002), Askary (2006) and Tsakumis (2007).

Thirdly, besides the descriptive analysis of the questionnaire survey, this study employs a number of statistical techniques. These techniques are: t-tests, factor analysis, ANOVA and Omega statistics and non-parametric tests (including Friedman Two Way ANOVA, and Wilcoxon Matched Pairs). This provides a comprehensive insight into the perceptions of auditor independence and the perceived reliability of audited financial statements. Using a variety of these statistical techniques is rarely found in the existing literature, especially within developing countries. Fourthly, this research adopts a multiple approach (mixed method) which is a quantitative approach using a standard questionnaire survey. The survey is complemented by a qualitative approach using semi-structured interviews to enhance and complement the results obtained by the questionnaire survey, so as to add credibility and enhance the reliability of the findings of this research.

8.3 Recommendations and Implications

Within a developing country such as Libya, Law 116/1973 does not prohibit any type of non-audit services. This service may be regarded as a source of threat (Fearnley et al., 2005) to the independence of auditors among the users of audited financial statements in this country. Therefore, the government or the regulatory body such as LAAA, may initiate rules that would govern the provision of non-audit services. For instance, LAAA may require audit firms to supply non-audit services to companies by a different department, or a team of auditors, other than that which audits the

company's financial statements. The other good practice would be that Libyan auditors are prohibited to supply non-audit services according to the rules of the SOX (2002) Act. Furthermore, it is feasible for LAAA to adopt the UK & IFAC independence framework.

It is also expected that LAAA would initiate rules that may require the rotation of auditors or audit partners after a certain period of time. A review of the literature documents that the Libyan accounting profession is oriented toward UK and US accounting practices (Ahmed and Gao, 2004), therefore it is recommended that LAAA should comply with the rotation requirements of these developed nations' good practice. Moreover, the Libyan accounting regulation should initiate rules which may require audit firms not to go beyond the limit, set out by APB (2004), of audit fees so that one-client audit fees should not exceed 15 percent of the total audit revenue. The practice would safeguard independence from the threat of self interest, according to Fearnley et al. (2005), which comes from the economic dependence by auditors on their audit clients.

The Libyan Accountants and Auditors Association (LAAA) would benefit from these findings, especially with regard to the development of national or domestic auditing standards and guidance in the country. The Libyan regulators, policy-makers and politicians should take serious action to regulate the audit profession and bring it more effectively in line with the International Accounting Standards (IASs) and the International Standards on Auditing (ISAs). For instance, the LAAA should introduce exams for new members to pass. This would enhance the quality of audit service in Libya and facilitate the country's application to WTO in terms of trading services (audit service is no exception) (Derwish et al., 2004). Moreover, the results of this study would benefit the International Federation of Accountants (IFAC) in the development of accounting and auditing standards harmonisation, especially after the opening and the emerging of the Libyan audit market where foreign investors demand high quality audit services. Moreover, transnational investors are also influenced by and affect local market characteristics; this may be taken into consideration in the harmonisation of global accounting and audit standards. This process entails empirical research worldwide in order to uncover the characteristics of audit markets in different societies.

In an attempt to safeguard the independent audit in Libya, the LAAA should introduce the practice of good corporate governance which appears not to exist in the country. For instance, the Libyan government should establish a governing body that may take responsibility for initiating disciplinary rules, audit committees and enforcing legal requirements that may safeguard the independent audit, ensuring that good practice is taking place. Finally, the International Federation of Accountants should consider the issue of auditor independence within a global context in that national and local accounting practices are shaped and developed by contextual factors such as politics and country-specific cultures. This wider context would be advantageous to transnational and multinational corporations. It is also useful for the Big 4 auditors who supply audit and accounting services at a global level.

8.4 Limitations and Venues for Future Research

There are also some limitations which need discussion. Firstly, other user groups like policy makers and / or regulators, institutional investors and officers within the tax authority are not covered in this study. It can be argued that research incorporating the perceptions of policy-makers (regulators) and institutional investors and tax authority officers may produce insights that are not revealed by other users of financial statements. There might be other factors, which may affect the perceived auditor independence and the perceived reliability of audited financial statements, which might not be identified. Secondly, the results reflect the perceptions of users and auditors of a particular culture (Libyan society) in a national development stage. This may have an impact on users' and auditors' attitude and perceptions and consequently the opportunities for generalisation of this study's results to other countries and may be restricted only to countries with similar cultural backgrounds.

Partitioning NAS would produce different results as to the effect of the components of non-audit services on the perceived reliability of audited financial statements. Incorporating audit committee compositions and activities such as frequency of meetings could produce different insights about its impact on the RAFS. Involving government-affiliated auditors and institutional investors may also produce different understandings of the issue of auditor independence and its impact on the perceived reliability of audited financial statements in Libya. The current research is focused on

the capital city of Tripoli, where most commercial activities and businesses are allocated. Future research would cover different cities in the region.

Moreover, a study across neighbouring countries or across regions that share similar cultural backgrounds would provide further insights about the influence of similar environmental and contextual factors. In addition, further research incorporating the perceptions of foreign investors may also produce additional insights and understanding that may not be revealed by other users of accounting information contained in the audited financial statements. Moreover, since the current study is concerned with auditor independence and its effect on the perceived reliability of audited financial statements in general, future research would investigate auditor independence and its effect on the perceived reliability of specific accounts within the financial statements such as earnings quality and accruals.

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Appendices

Appendix 1: Law No 116/ 1973

This law has been enacted by the Libyan government in order to organise and develop the accounting profession in the country in late 1973. The law No.116 of 1973 comprises eight sections. These sections are as follows: (1) The establishment of the LAAA; (2) Registration of accountants; (3) Exercise of the profession; 4) Fees; (5) Pension and contribution fund; (6) Responsibility of accountants and auditors; (7) Penalties; and (8) General and transitional provisions.

Registration with LAAA

Any accountant in Libya must not practice the auditing profession in the country unless s/he is registered as a chartered accountant with the LAAA (Law No.116, article 32). The purpose of registration is to ensure that audits are performed by persons who are properly supervised and appropriately qualified.

The following are the conditions of registration in the LAAA: (1) Citizenship: applicants for the membership of the LAAA must be citizens of Libya; (2) Residence: applicants should reside in Libya; (3) Education experience: applicants should have an accounting degree from the Faculty of Economic and Commerce of the Libyan University, or any other recognised university or higher institute. For applicants to be registered on the accountants register they must have at least five years' experience of accounting work in an accounting office after graduation. Those who have a degree higher than a bachelor's degree are exempt from the experience requirement provided that the higher degree required four or more years training.

Those who are already practicing the profession who do not have a university or higher institute degree should be registered as working auditors on condition that they may only be considered as accountants' or auditors' assistants, if they have less than five years experience. If they have five years experience or more in a full time accounting job and pass a special examination designed by the LAAA, they would be able to register as chartered accountants. The executive's memorandum of the law No.116 of 1973 explained article 24 of the law which related to the required qualifications and experiences to register with the LAAA.

The explanation of the executive's memorandum is as follows: Qualifications and experiences, which are required to register as a chartered accountant, are: (1) Doctoral degree in accounting, auditing, taxation or costing from any recognised Arabic or international university; (2) Membership of the Institute of Chartered Accountants in England and Wales; (3) Membership of the American Accountants Association; (4) Any certificate equivalent to those mentioned above obtained from any recognised universities or institutes specialising in accounting or auditing that required four years or more for graduation; (5) Bachelor's degree in accounting in addition to five years' experience of accounting work in an accounting office or doing one of the following jobs:

(A) Manager or head of an accounting or auditing department in the Treasury Ministry; (B) Accountant or auditor working for the Accounting Council; (C) Accountant or auditor working for the Taxation Authority; (D) Manager or head of an accounting department in public banks or enterprises; (E) Teacher of accounting or auditing in any public universities or institutes; (F) Any other jobs equivalent to the jobs mentioned above approved by the LAAA. (6) Three years' experience of work with the jobs mentioned above in addition to the following: (A) Membership of the Chartered Institute of Management Accountants in England and Wales or any equivalent certificate; (B) Membership of Association of Chartered Certified Accountants in England or any equivalent certificate; (C) Membership of the Taxation Association in England or any equivalent certificate.

LAAA Membership Categories & Exercise of the Profession

The Association is run by a board of directors which consists of a chairman and eight members. These members are elected by the General Assembly of the LAAA. The board selects one of its members as vice chairman, another as treasurer and a third as a secretary (law No.116, articles 10, 11). The membership of the profession is divided into four categories: 1) Schedule of working accountants and auditors which is composed of: (A) Schedule of accountants and auditors; (B) Schedule of accountants' and auditors' assistants; (2) Schedule of non-working accountants and auditors that is composed of: (A) Schedule of non-working accountants and auditors; (B) Schedule of non-working accountants' and auditors' assistants.

Those members who are registered in category (1a) can set up their offices or firms to practice the profession using the title "Chartered Accountants", and have the right to certify

accounts and balance sheets of all types of firms and taxpayers. They also have the rights to represent their clients with tax authorities and other authorities. Members who are registered in schedule (1b) may only establish their own offices or firms if they had at least two years' experience with those who are registered in schedule (1a). However, they may only certify accounts and balance sheets of firms with no shares. They can also certify accounts of taxpayers who are subject to taxes on incomes from commerce, industry and independent professions whose capital does not exceed 20,000 Libyan dinars or whose annual net income does not exceed 5,000 Libyan dinars according to the last certified financial statements or tax declaration. They are also allowed to certify accounts of taxpayers who are subject to general tax on income and whose revenue does not exceed 10,000 Libyan dinars according to the last tax declaration.

The Independence Status of the Auditors

With the object of maintaining the auditor's independence, Law No. 116 of 1973, which is still the only law organising the auditors' work, prohibits auditors from combining their status as a chartered accountant with certain activities such as: (1) A ministerial position; (2) Any public post, permanent or temporary, with salary or compensation (unless s/he was permitted to do so according to the provision of this law); (3) Any commercial activities; (4) All other activities which are not compatible with the profession (Law No.116 article, 25). Furthermore, it is illegal for the members of the LAAA to advertise or to use mediators in order to practice the accounting profession, and all the members of the LAAA are required to meet all obligations that may be imposed on them by the law and by the ethics of the profession (Law No.116, article 49).

Auditor's Responsibility

The responsibility of the auditor towards clients relates to confidentiality of client information and to contingent fees, while responsibility to the public derives from due care and prudence by the chartered accountant in expressing his / her opinion on the financial statements. Article 51 of the law of LAAA explains that the chartered accountant should refuse to communicate any information about his / her client known to him / her as a result of his / her professional practice unless his / her purpose is to prevent criminal action. Article 50 indicates that the auditor must not use advertisement or middlemen to attract clients. Article 49 came to emphasise the importance of the professional ethics and states that the accountant and chartered accountant should operate according to the principles of

honesty and should fulfil all the duties, which are imposed on him /her by the law and by the ethics of the profession. Article 52 came to highlight the general responsibility of the auditor towards his / her colleagues. This article required the auditor to treat and behave with his / her colleagues in accordance with the professional principles and with honesty and integrity.

Penalties

To continue practicing the auditing profession in accordance with the profession's law and principles, law No.116, devoted some articles to penalties. According to the law No. 116, only accountants who meet the qualifications will be admitted into the profession, and individuals can be suspended or expelled from the profession if they do not live up to its standards. In this concern, article 53 indicates that the LAAA may give a warning, suspend a member for up to three years or expel him / her if s/he commits acts which are degrading to the profession by violating the requirements of honesty and integrity in his / her professional work. The expulsion, suspension or warning is decided upon by a committee of two persons chosen by the board of directors of the LAAA. The expulsion of a chartered accountant must be applied in those cases where there is: (A) A loss of Libyan nationality; (B) A chartered accountant is sentenced for civil proceedings. Article 56, indicated that a chartered accountant may also be prosecuted by the public prosecutor.

Fees

Professional fees should be a fair reflection of the value of the professional services performed for the client. The professional fees should be calculated in an appropriate way, such as on the basis of the number of audit work hours or per day for the time of each person involved in the services. In fact the law No.116 of 1973 does not state a specific manner to compute the auditing professional fees. However, Article 38 explains that in the case of disagreement between the chartered accountant and the client concerning the audit fees, they should bring the matter to the board of directors of the LAAA who should find the solution to this disagreement within sixty days from the date of the case being reported.

Appendix 2: Total number of (LAAA) members

Type of membership	Number
Accountants in practice	976
Assistant accountants in practice	100
Assistants not in practice	420
Total	1496

Source: LAAA membership directory (2008).

Appendix 3: Proposed Auditor Independence Framework in Libya

1.Auditor appointment	Countries which have stable professional accounting bodies, auditors are registered in membership directory, and the clients request to recruit auditors who are short listed by the professional body, and then auditor is appointed (hired) by the general assembly of shareholders.
2.Auditor dismissal	The appointing party has the right to change or fire the auditor on the basis of clear evidence that convicts him/her. The auditor, in case of prosecution, has the right to defend him/herself.
3.Fee determining	Fee should be determined by the professional body or government party who has previously selected the auditor for two reasons: (A) Shareholders are not expert in accounting and auditing, therefore they are not able to reasonably set the price of audit work (time and effort). (B) Avoiding negotiation and / or conditional and determined fees in advance without knowing the volume and type of audit work.
4.Conflicting duties	Auditors should comply with the following: A. Auditor should have no financial or personal relationships (e.g. family member or partnerships) with their clients (e.g. board of directors, managers, employees and shareholders). (B) Avoiding any duty that may conflict with audit work (C) Auditors should not borrow or lend to clients. (D) Ex-auditors should be allowed to engage in a post (within audited entity) after a 5-year cooling-off period or after changing board of directors.
5. Access	A. Auditors should have full access to all books, records and any other relevant documents that auditors need to fulfil their investigation and scrutiny. (B) Clients' management and employees should provide all information, data, and clarification which auditors consider important to carry out their audit. (C) Clients' management should help and allow auditors to investigate the company's assets and its liabilities.
6.Auditors' duties	A. Auditors should comply with professional standards, and any departure from these standards, auditors become accountable and liable (face legal actions).B. Auditor should submit audit report including the outcomes of their audit work, and their opinion. Auditors are also responsible and liable for the audit report contents (liability towards interested parties who use the audit report including corporate social responsibility towards society). (C) Auditors should attend general assembly meetings and respond and clarify all questions and queries regarding the content of their audit report. (D) Auditors should comply with professional codes and ethics when they perform their audit duties.
7.Ensuring team-work independence	(A) Auditor should conduct intensive procedure to determine to what extent the team-work members are independent both accountant assistant and specialist experts (e.g. environment and management experts, system experts etc). (B) Ensuring that there are no personal or financial interests (e.g. family relationship, partnership, employment) between team-work members and clients of audited entity.

Source: Mohamed (2004,p: 234).

Appendix 4: The Form of Libyan Auditors' Report

"We certify that we have examined the balance sheet of the Libyan National Company for Free Trading as of 31 December, 2000 and statements of trading, profit and loss and retained profits for the year then ended. Our examination was made in accordance with generally accepted auditing standards and accordingly included such tests of all accounting records and such other auditing procedures as we considered necessary in the circumstances. In our opinion, the balance sheet of the company and the trading statement, profit and loss and retained profits present fairly the financial position of the company at 31 December, 2000 and the result of its operations for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

(Signature)

(Date)".

Source: Khorwatt (2006, p: 35).

Appendix 5: Big 4 Auditors in Libya

- PricewaterhouseCoopers is joined with Ghattour & Partners.

Ghattour & Partners
PricewaterhouseCoopers
Jamhuria St.
Almansora District
Tripoli, Libya
Telephone: +218 21 7180175

- Ernst & Young was joined with Mohammed Kanon. On November 2007 E&Y opened its own office in Tripoli as Ernst & Young & Partners.

Ernst & Young & Partners Libya
P O Box: 91873
Tripoli, Libya
Telephone: +218 21 33 35 350

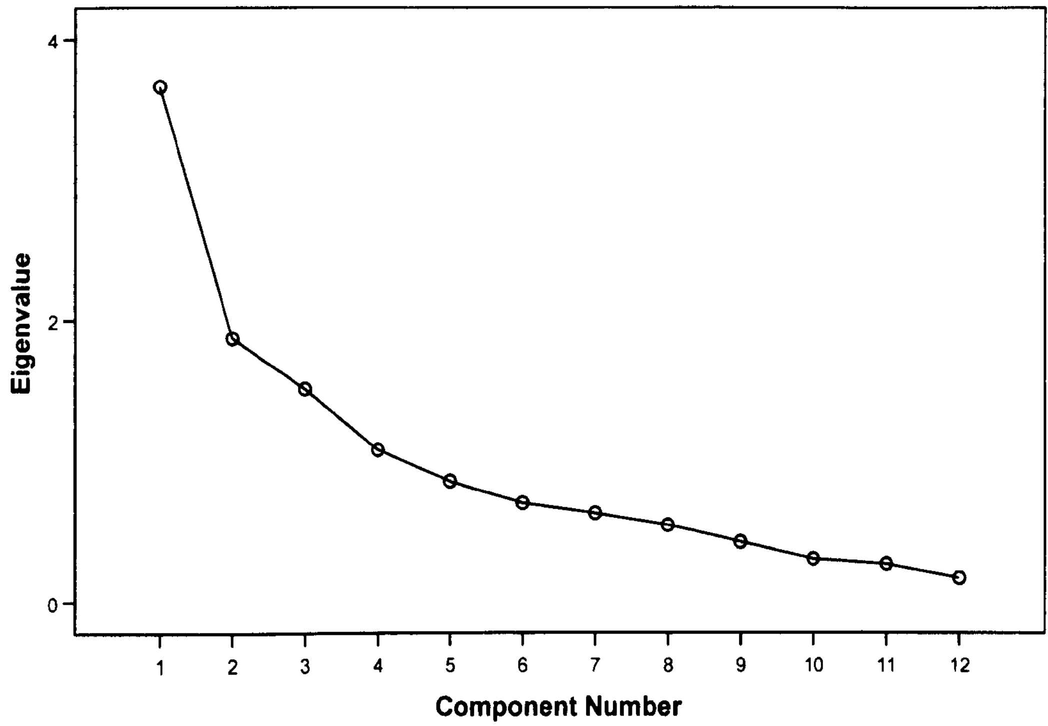
- Deloitte is joined with Kashadah & Co.

Deloitte Libya
Kashadah & Co.
4 Damascus Street
P.O. Box 4769
Tripoli, Libya
Telephone: + 218 21 333 0941

- KPMG involved in partnership with United Accountants (Hussein Abu Nawara & Co)

KPMG and Abu Nawara have provided audit services to the Libyan Foreign Bank and both have signed on the audit report which includes their opinion on the Bank's financial statements, on the period ended on 31/12/2007, in accordance with the International Standards on Auditing. They state that "*the financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on these financial statements based on* [their] *audit*" LFB (2008,p: 27).

Appendix 6: Scree Plot



Appendix 7: Anti-Image Correlation Matrix

Variables[67]	BIG4	LRGOFC	FEE	AC	NAS	NASN	ROTAT	LEGAL	LDISTD	COMPT	SMLOFC	SOCIAL
BIG4	0.3707											
LRGOFC	-0.0931	0.2752										
FEE	-0.0123	-0.0849	0.5559									
AC	-0.1367	-0.0470	-0.0450	0.5581								
NAS	0.0003	0.0880	-0.2414	0.0096	0.6186							
NASN	0.0467	-0.0629	-0.0290	-0.0243	0.0704	0.8963						
ROTAT	-0.0719	-0.1622	-0.0003	-0.0388	-0.0795	-0.0050	0.3008					
LEGAL	-0.0338	-0.0011	-0.0276	-0.0073	-0.1055	-0.1892	0.0975	0.8086				
LDISTD	-0.1013	-0.0268	0.0953	0.0506	0.0268	0.0321	-0.0085	-0.1145	0.6292			
COMPT	-0.0367	0.0167	-0.2019	0.1008	0.1080	0.0716	-0.0401	-0.0942	-0.0842	0.6241		
SMLOFC	-0.0020	-0.0519	0.0970	-0.0945	-0.1917	-0.0705	0.0572	-0.0135	0.1599	-0.2822	0.5877	
SOCIAL	0.1154	-0.0623	-0.0498	0.0143	0.1048	0.0535	0.0491	-0.0938	-0.2538	0.0107	0.0008	0.6623

[67] *BIG4 = Audit is performed by one of the Big 4 auditors. LRGOFC = Audit is performed by large local audit office. FEE = one-client audit fees exceed 15% of total audit revenue. AC= Audit committee existence within audit client's company. NAS = Auditors provide non-audit services to audit client. NASN = Auditors provide non-audit services to non-audit client. ROTAT = Rotating auditors every 5 years. LEGAL = Audit market lacks legal incentives. LSISTD = Audit Market lacks domestic independence standards. COMPT = Audit service is performed within high competitive audit market. SMLOFC = Audit service is performed by small audit office. SOCIAL = Influence of socio-cultural relationships within the Libyan society.*

University of Liverpool

Management School

An Empirical Investigation into Perceptions of Auditors' Independence and the Perceived Reliability of Audited Financial Statements: The Case of Libya

2008

The Questionnaire

Dear Participant,

I am pursuing my doctoral studies at the University of Liverpool Management School. This questionnaire is part of my studies and is required for the completion of this research. My project is entitled "**An Empirical Investigation into the Perceptions of Auditor's Independence and the Perceived Reliability of Audited Financial Statements: The Case of Libya**". The objective of this survey is to seek the perceptions of users of financial statements, in making their business decision, regarding factors which may have an impact on auditors' independence and consequently affect the reliability of financial statements. This study also seeks the perceptions of the external auditors themselves about the issue of independence.

I will be very grateful if you could spare some time and participate by filling the questionnaire. Your participation will provide invaluable input that is vital to the success of this study. All information will be treated as highly confidential and will be used for academic purposes only.

Shamsaddeen Faraj
PhD student
Primary Supervisor: **Dr Saeed Akbar**
The University of Liverpool Management School
Chatham Street
Liverpool
L69 7ZH
Email: shamsaddeen.faraj@liverpool.ac.uk
United Kingdom.

An Empirical Investigation into Perceptions of Auditor's Independence & the Perceived Reliability of Audited Financial Statements: The Case of Libya

The Questionnaire

Part One: General Information

1. About the Respondent

A) Job Title:

- ☐ Commercial Loan Officer
- ☐ Investor
- ☐ Owner
- ☐ Manager
- ☐ Auditor
- ☐ Other, Please specify:………………

B) Professional / University Qualification:

- ☐ ACCA
- ☐ CIMA
- ☐ CA
- ☐ PhD
- ☐ Masters
- ☐ Bachelor's
- ☐ Other, please specify

C) Age

C) Age	Under 30 Yrs	Between 30-40 Yrs	Between 41 & 50 Yrs	Over 50 Yrs
You are:	☐	☐	☐	☐

D) Experience

D) Experience	Less than 5 Yrs	6-10 Yrs	More than 10 Yrs
In your current position	☐	☐	☐

E) Do you have any Professional Training?

- ☐ Yes
- ☐ No

F) If yes, which of the following would best describe the organisation that you trained with ?

- ☐ Big 4 Audit firms
- ☐ Government
- ☐ Other please specify:…………….

2. About the Organisation

A) The Ownership:

- ☐ State-owned entity (more than 50% of shares are owned by the state)
- ☐ Private entity (more than 50% of shares are owned by private owners)
- ☐ Other, please specify:……………………….

B) Type of business

- ☐ Banking
- ☐ Manufacturing
- ☐ Commercial
- ☐ Government Auditing
- ☐ Statutory Auditing
- ☐ Other, please specify:…………

C) Number of Employees:

- ☐ Less than 50
- ☐ 50-100
- ☐ 101-200
- ☐ 201-500
- ☐ More than 500

Part two: Auditor Independence

3. Are there any particular instances where you have suspected a lack of auditor independence?

- ☐ Yes
- ☐ No

4. If your response to Q3 is Yes, in those instances where you have suspected a lack of Independence,what gave rise to such suspicions? (Please tick any which are appropriate)

(a) audit was performed by small audit firm ☐
(b) auditor continued in office for the same client for more than 5 years ☐
(c) the company did not have an audit committee ☐
(d) audit firm provided non audit services to the audit client ☐
(e) one-client audit fees exceed 15% of total audit revenue ☐
(f) lack of legal incentives to maintain independence ☐
(g) audit was conducted within high competitive audit environment ☐
(h) socio-culture relationship between auditors and their client exist ☐

Part Three: the Usage of Audited Financial Statements and Auditor Independence

5) In your organisational role, do you use audited financial statements for financial decisions making (e.g. lending, investment, etc)?

(a) Always ☐
(b) Often ☐
(c) Sometimes ☐
(d) Rarely ☐
(e) Never ☐

If your response to this question is (d) "Rarely" or (e) "Never" Please go to Q 12; otherwise go to Q 6

6. In your organisational role, what importance do you attach to audited financial statements for lending/ investment decisions?

(a) Very important ☐
(b) Important ☐
(c) Moderately important ☐
(d) Slightly important ☐
(e) Unimportant ☐

7. When using audited financial statements for lending/ investment decisions, do you specifically consider reliability?

(a) Always ☐
(b) Often ☐
(c) Sometimes ☐
(d) Rarely ☐
(e) Never ☐

If your response to this question is (d) "Rarely" or (e) "Never" Please go to Q 9; otherwise go to Q 8

8. In assessing the reliability of financial statements, how often do you consider the independence of the auditor?

(a) Always ☐
(b) Often ☐
(c) Sometimes ☐
(d) Rarely ☐
(e) Never ☐

If your response to this question is (d) "Rarely" or (e) "Never" Please go to Q 10; otherwise go to Q 9

9. If you perceive the auditor is NOT independent, how would this affect your confidence in the reliability of the audited financial statements?

(a) Decrease confidence significantly ☐
(b) Decrease confidence to some extent ☐
(c) No effect on confidence ☐

10. In deciding on the amount to lend / invest in a company, how often do you specifically consider the independence of the auditor ?

(a) Always ☐
(b) Often ☐
(c) Sometimes ☐
(d) Rarely ☐
(e) Never ☐

[If your response to this Q is (d) "Rarely" or (e) "Never" Please go to Q 12; otherwise go to Q 11].

11. If you perceive the auditor is NOT independent, how would this impact on the amount that you would lend / invest in the company

(a) Lend/Invest more ☐
(b) No effect ☐
(c) Lend/Invest less ☐
(d) Would not lend/Invest at all ☐

Part Four: Factors Affecting Auditor Independence and Reliability of Audited Financial Statements:

*Questions from **12** to **22** provide details of different factors which might have an impact on the auditor independence. Please indicate your response on the importance of these factors by circling the number on the scale from **1** to **5** . **1** = Strongly undermines independence, **2** = undermines independence, 3 = no effect on independence, **4** = enhances independence, **5** = strongly enhances independence.*

Level of Response

12. Audit services are provided by Big 4 auditors. 1..................2..................3..............4...........5

13. Audit services are provided by large audit office 1..................2..................3..............4...........5

14. One-client audit fees exceed 15 % of total audit revenue. 1..................2..................3..............4...........5

15. The existence of an audit committee within the client company 1..................2..................3..............4...........5

16. Along with audit service, auditor provides non-audit service to clients 1..................2..................3..............4...........5

17. Auditor provides non-audit services to non audit clients 1..................2..................3..............4...........5

18. Rotating auditor more often (e.g. every 5 yrs) 1..................2..................3..............4...........5

19. Lack of legal incentives to maintain independence (e.g. absence of commercial court) 1..................2..................3..............4...........5

1 = Strongly undermines independence, 2 = undermines independence, 3 no effect on independence, 4 = enhances independence, 5 = strongly enhances independence.

	Level of Response
20. Absence of domestic Auditing Standards (e.g domestic independence standard)	1..................2.................3..............4...........5
21. Providing audit service within competitive audit environment	1..................2.................3..............4...........5
22. An audit services provided by small audit firm.	1..................2.................3..............4...........5

Questions 23 to 32 refer to a variety of audit situations. For each situation, please indicate how often you ***would consider the financial statements to be reliable***, by circling the appropriate number on a scale of **1** to **5**

*1 = Always (**A**), 2 = Often (**O**), 3 = Sometimes (**S**), 4 = Rarely (**R**), 5 = Never (**N**).*

	Financial Statements Considered *to be Reliable*
	A...............O............ ....S..............R...........N
23. From a company's financial statements, you observe that the audit is performed by a:	
(a) Big-4 audit firm	1..................2.................3..............4...........5
(b) Large Audit Office	1..................2.................3..............4...........5
24. The audit of the company is undertaken in an audit environment which is considered to:	
(a) be highly competitive	1..................2.................3..............4...........5
(b) have low competition	1..................2.................3..............4...........5
25. From the company's audited financial statements, you note that the company:	
(a) has an audit committee	1..................2.................3..............4...........5
(b) does not have audit committee	1..................2.................3..............4...........5
26. You have been informed that non-audit services provided to the company by:	
(a) personnel involved in the audit	1..................2.................3..............4...........5
(b) a separate department within the firm	1..................2.................3..............4...........5
(c) an audit firm not involved in the audit	1..................2.................3..............4...........5
(d) the auditor to all clients, but full disclosure is	1..................2.................3..............4...........5
made in the client's financial statements	1..................2.................3..............4...........5
27. You have been informed that the company has had the same audit firm for:	
(a) 10 years	1..................2.................3..............4...........5
(b) 5 years	1..................2.................3..............4...........5
(d) less than 5 years	1..................2.................3..............4...........5

1 = Always (A), 2 = Often (O), 3 = Sometimes (S), 4 = Rarely (R), 5 = Never (N).

Financial Statements Considered
to be Reliable

	A..............O.......... ....S............R..........N
28. You have been informed that the partner in charge of the company's audit has been in charge for:	
(a) 10 years	1..................2................3.............4..........5
(b) 5 years	1..................2................3.............4..........5
(d) less than 5 years	1..................2................3.............4..........5
29. You have been informed that the audit manager in charge of the company's audit has been in charge for:	
(a) 10 years	1..................2................3.............4..........5
(b) 5 years	1..................2................3.............4..........5
(d) less than 5 years	1..................2................3.............4..........5
30. The audit of the company is undertaken in an audit environment where there is a:	
(a) strong legal incentives regulating audit services	1..................2................3.............4..........5
(b) lack of legal incentives to maintain independence	1..................2................3.............4..........5
31. The audit of a company is undertaken by an auditor where you note that:	
(a) the audit fees paid to the auditor is more than 15 % of the total audit revenue	1..................2................3.............4..........5
(b) the audit fees paid to the auditor is less than 15 % of the total audit revenue	1..................2................3.............4..........5
32. The audit of a company is undertaken by an auditor who:	
(a) does have a social-relationship with the client	1..................2................3.............4..........5
(b) does not have a social-relationship with the client	1..................2................3.............4..........5

Part Five: Auditor Independence and Audit Conflict

Questions 33 & 36 for Auditors only. (If you are not auditor nor manager go to section six).

33. Are there any particular instances where you have a dispute with your client(s) ?

☐ Yes ☐ No

34. If your answer is Yes, in those instances where you have a dispute with your client, what gave rise to such conflicts? (Please tick any which are appropriate)

(a) discovered improper accounting treatment ☐
(b) switching between accounting rules that resulted in material difference to income ☐
(c) inadequate disclosure regarding item(s) within the financial statements ☐
(d) unrecorded transaction(s) that you believe it has material impact on the financial statements ☐
(e) client management fail to meet agreed audit timetable ☐

35. Have you ever provided an adverse audit report?

☐ Yes ☐ No

36. Has the issuance of such report resulted in losing the audit client?

☐ Yes ☐ No

Questions 37 & 40 for Managers only

37. Are there any particular instances where you have a dispute with your auditor(s) ?

☐ Yes ☐ No

38.If your answer is Yes, in those instances where you have a dispute with your auditor, what gave rise to such conflicts? (Please tick any which are appropriate)

(a) time pressures caused by late adjustments ☐
(b) switching between accounting rules that resulted in a big difference to income ☐
(c) inadequate disclosure regarding item (s) within the financial statements ☐
(d) unrecorded transaction (s) that may have material impact on the financial statements ☐
(e) non-compliance to accounting rules (flexible use of accounting practice) ☐

39. Have you ever received an adverse audit report ?

☐ Yes ☐ No

40. Has the issuance of such report resulted in changing the auditor?

☐ Yes ☐ No

Part Six: Importance of Audit Report

For Question 41 please circle the appropriate number in a scale of **1** to **5** (**1** = very important, 2 = important, **3** = undecided, **4** = not important, **5** = not important at all.

41. To what extent you consider the audit report is important?

Level of Response

1……………….2………………..…………...3………..………….4………………….....5

Part Seven: Influence of Social Relationships on Auditor Independence

42. Do you think that social relationships have an impact on auditor independence ?

☐ Yes ☐ No

43. If your answer is Yes, please draw a circle on a scale of 1 to 5 to indicate your response to the influence of social relationships on auditor independence

1 = Strongly undermines independence, 2 = undermines independence, 3 = no effect on independence 4 = enhances independence, 5 = strongly enhances independence.

Level of Response

1……………….2……………………..…...3……..………..…….4………………….....5

44. Please use this space for any additional comments that you may have on the issues addressed in this questionnaire.

End of Questions ---------------- Thank you.

Explanation of some of the terms that follow:

(You may wish to refer to these as you complete the questionnaire)

Auditors: Registered external auditors performing statutory company audit.

Users: Owners, Investors, Lenders, and Managers in the commercial and corporate environment in Libya.

Auditor independence: The auditors' ability to be, and be seen to be, objective and impartial, i.e., free from bias towards any of the parties in relation to whom they are acting.

Audit firm: The audit firm that is providing audit services such as auditing financial statements, and other accounting services

Tenure of Audit Firm: This refers to the time period over which an audit firm provides audit service to the same client.

Non-audit services: This refers to the provision of taxation advice, the design and installation of financial and cost accounting systems etc.

Level of Competition: High level of competition is when there is a large number of audit firms that are aggressively pursuing expansion programmes in terms of increasing client numbers. Whereas low level of competition is when there are just a few or no competing firms in the audit market.

Audit Fees: Audit Fees paid by clients to their auditors.

Audit Committee: The committee which is composed of non-executive directors whose duty is to act as a proxy for shareholders in matters concerning the audit, including auditors' appointment, remuneration and accountability of auditors.

Legal incentives: Refers to the framework & audit service structure including laws and regulation that auditors comply with e.g. independent audit standards, laws applied in case of lawsuits, auditor's liability.

Big 4 Audit Firms: Refer to the big international accounting firms KPMG; Deloitte; Ernst & Young; and PriceWaterhouseCoopers.

ACCA: Refers to the Association of Chartered Certified Accountants.

CIMA: Refers to the Chartered Institute of Management Accountants.

CA: Refers to a Chartered Accountant.

Reliability: Information has the quality of reliability when it is free from material error and bias. It can also be depended upon by users to represent faithfully in terms of valid description that it either contends to represent or could reasonably be expected to represent.

Appendix 9: Interview Questions

Sequence	Question	Aim of the question
1	Would you please assess the importance & use of audited financial statements including the audit report for decision making?	To enhance and complement the response of the questionnaire regarding the importance and use of audited financial statements for decision making.
2.	Would you please tell me about the reasons that may lead you to suspect a lack of independence?	To enhance and complement the response of the questionnaire regarding the reason that may lead to suspicions of a lack of independence.
3	How would you distinguish between audit services provided by different sizes of auditors (e.g. Big 4 auditor. large audit office & small audit office)?	To enhance and complement the response of the questionnaire regarding the effect of audit firm size on the perceived independence of auditors.
4	How would you interpret the impact of one-client audit fee (exceeding 15% of total audit revenue) on the independent audit?	To enhance and complement the response of the questionnaire regarding the effect of audit fee size on the perceived independence of auditors.
5	How would you interpret the impact of competition in the audit market on the independent audit?	To enhance and complement the response of the questionnaire regarding the effect of competition on the perceived independence of auditors.
6	How would you interpret the impact of the provision of non-audit services on the independent audit?	To enhance and complement the response of the questionnaire regarding the effect of non-audit services on the perceived independence of auditors.
7	Would you please tell me about the legislations and institutional incentives related to the external independent audit?	To enhance and complement the response of the questionnaire regarding the effect of legal incentives on the perceived independence of auditors.
8	How would you interpret audit committee role in maintaining an independent audit?	To enhance and complement the response of the questionnaire regarding the effect of audit committee existence on the perceived independence of auditors.
9	How would you interpret the rotation of auditors?	To enhance and complement the response of the questionnaire regarding the effect of auditors rotation on the perceived independence of auditors.
10	Would you please tell me about the association between Libyan social relationships and the external independent audit?	To enhance and complement the response of the questionnaire regarding the effect of the Libyan social relationships on the perceived independence of auditors.
11	Could you please tell me about the reliability of audited financial statements in Libya?	To enhance & complement the response of the questionnaire regarding the perceived independence and its affect on the reliability of audited financial statements.
12	Could you please tell me about the dispute you may have with your client(s)/ Auditor(s).	To enhance and complement the response of the questionnaire regarding the audit dispute that may occur between auditors and their clients.

Appendix 10: The Questionnaire (Arabic Version)

جامعة ليفربول

دراسة لانجاز متطلبات الاجازة الدقيقة بعنوان:

العوامل المؤثرة في إستقلالية المراجع الخارجى وعدالة القوائم المالية فى ليبيا

2008

استمارة استبيان

توضيحات لبعض المصطلحات الواردة بالاستبيان:-

المراجع: يقصد به المراجع الخارجي المقيد بنقابة المحاسبين والمراجعين القانونيين أو أية رابطة مهنية أخرى.

استقلالية المراجع: هي قدرة المراجع على أن يكون موضوعي ونزيه وان يكون في نظر الآخرين أيضا مستقلا عن عملائه.

شركة المراجعة: الشركة التي تقدم خدمات المراجعة القانونية مثل فحص ومراجعة القوائم المالية.

دوران فترة المراجعة: فترة المراجعة التي يقوم خلالها المراجع بتقديم خدماته لنفس العميل.

تقديم خدمات استشارية وفنية: تلك الخدمات التي يقدمها المراجع لعملائه, من أمثلة ذلك: إمساك دفاتر, تصميم أنظمة محاسبية, خدمات ضريبية, وغيرها.

المنافسة: مستوى المنافسة حول تقديم خدمات المراجعة الخارجية يكون حاد في ظل وجود عدد كبير من شركات المراجعة داخل سوق المراجعة.

أتعاب المراجعة: هي عبارة عن مقابل ما يقدمه المراجع من خدمات لعملائه.

لجنة المراجعة: هي لجنة تتكون من مدراء غير تنفيذيين يقومون بدور الوكيل لحملة الأسهم والملاك في مراقبة عمل المراجعين.

القوانين والتشريعات التنظيمية: الهيكل والإطار القانوني المنظم لعمل المراجعة القانونية, مثل القوانين والمعايير والإجراءات القضائية المتبعة في حالة وجود نزاعات المراجع طرف فيها, بالإضافة إلى المحاكم التجارية المختصة.

شركات المحاسبة العملاقة الأربعة: شركات المحاسبة متعددة الجنسية ذات الفروع في معظم أنحاء العالم.على سبيل المثال تم استحداث فرع **ارنست و ينغ** بطرابلس مؤخرا.

مصداقية القوائم المالية: تدل على صدق وصحة المعلومات المحاسبية المدرجة القوائم المالية, أو بمعنى أخر تدل على خلو المعلومات المحاسبية من الأخطاء والتلاعب بحيث يمكن الاعتماد على تلك المعلومات في اتخاذ القرارات من قبل مستخدميها.

ACCA مؤسسة المحاسبين القانونيين

CIMA: المعهد المهني للمحاسبين الإداريين

CA: محاسب قانوني.

عزيزي المشارك:

الباحث طالب بجامعة ليفربول يقوم بدراسة الإجازة الدقيقة "الدكتوراه". هذا الاستبيان هو جزء من متطلبات الدراسة لإنجاز البحث.

الدراسة بعنوان

" العوامل المؤثرة في استقلالية المراجع الخارجي وعدالة القوائم المالية في ليبيا ".

الهدف الرئيسي من هذه الدراسة هو الحصول على أراء ومفهوم مستخدمي القوائم المالية في اتخاذ القرارات، وذلك في ضوء مجموعة عوامل والتي يُعتقد بأن لها تأثير على استقلالية المراجع وكذلك على عدالة القوائم المالية التي تمت مراجعتها من قبل المراجع الخارجي.

مشاركتكم سوف تساهم بشكل فعال في نجاح هذه الدراسة .كل المعلومات سوف تُعامل بكامل السرية والخصوصية حيث أن المعلومات سوف تستخدم للأغراض الأكاديمية.

أشكر لكم حسن تعاونكم ومشاركتكم في تعبئة الاستمارة.

إذا كنت ترغب في الحصول على ملخص بنتائج الدراسة يرجى تعبئة البيانات التالية:

الاسم	
رقم الهاتف	
البريد الالكتروني	
مكان العمل	

جامعة ليفربول .
شمس الدين محمد خميس
طالب دكتوراه.
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"العوامل المؤثرة في إستقلالية المراجع الخارجي وعدالة القوائم المالية

دراسة تطبيقية فى ليبيا"

" استمارة استبيان "

الجزء الاول :- معلومات عامة

س 1: معلومات حول المشارك :

أ - المهنة

( ) موظف إئتمان ( ) مستثمر ( ) مالك
( ) مدير ( ) مراجع خارجى

ب- المؤهل العلمى أو المهنى:

ACCA ( ) CIMA ( ) CA ( )
PhD ( ) MSc ( ) BSC ( )

ج- العمر: ( ) أقل من 30 ( ) مابين 30-40 ( ) مابين 41-50 ( ) أكثر من 50

د- هل تحصلت على تدريب متخصص.

( ) نعم ( ) لا

هـ- إذا أجبت بنعم ، أى المؤسسات التالية قامت بتدريبك :

( ) احدى شركات المحاسبة الدولية ( ) جهة حكومية ( ) غيرها، حدد.......

س 2 : بيانات حول المؤسسة التي يشتغل بها المشارك :

1- بيانات حول المؤسسة التى تشتغل بها :

أ- ملكية المؤسسة:

( ) شركة أو قطاع مملوك للدولة (أكثر من50% مملوك للدولة)
( ) شركة خاصة (أكثر من 50% مملوكة من قبل أفراد ملكية خاصة)
( ) غيرها، حدد ....

ب- نوع النشاط :

( ) مصرفى ( ) صناعي ( ) تجارى
( ) مراجعة حكومية (جهاز المراجعة المالية) ( ) مراجعة قانونية (مكاتب خاصة)
( ) غيرها، حدد

ج- عدد الموظفين :

( ) أقل من 50 ( ) من 50-100 ( ) من 101-200 ( ) من201-500 ( ) أ كثر من 500

الجزء الثاني:- استقلالية المراجع الخارجي

س3- هل هناك حالات لفتت انتباهك بأن المراجع غير مستقل أثناء إطلاعك أو فحصك للقوائم المالية لشركة ما ؟

( ) نعم ( ) لا

س4- إذا أجبت بنعم، ماهى الأسباب التى أدت إلى ذلك الاعتقاد (إختر كل أو بعض ما تراه مناسب):

( ) تقديم خدمات مراجعة من قبل مكتب مراجعه صغير الحجم .
( ) استمرار المراجع فى تقديم خدمات مراجعه لنفس العميل لفترة زمنية أكثر من 5 سنوات.
( ) الشركة محل المراجعة لايوجد بها لجنة مراجعة .
( ) المراجع يقوم بتقديم خدمات استشارية مالية بجانب خدمات المراجعة للزبون.
( ) أتعاب المراجعة من زبون معين تزيد عن 15 بالمائة من إجمالي دخل مكتب المراجعة.
( ) عدم وجود ضوابط قانونية تحافظ على الاستقلالية.
( ) خدمات المراجعة تقدم خلال بيئة تنافسية عالية.
( ) وجود علاقة إجتماعية بين المراجع والزبون.

الجزء الثالث:- استخدام القوائم المالية واستقلالية المراجع الخارجي .

س5- في دورك الوظيفي هل تعتمد في اتخاذك للقرارات على القوائم المالية التى تمت مراجعتها (الاستثمار أو الإقراض أو غيرها) ؟.

( ) دائماً
( ) في الغالب
( ) أحياناً
( ) نادراً
( ) مطلقاً لا

إذا أجبت (نادراً أو مطلقاً لا) إذهب إلى سؤال رقم 12 أو أجب السؤال رقم 6.

س6- ماهى الاهمية التى توليها للقوائم المالية التى تمت مراجعتها في إتخاد القرارات أثناء القيام بدورك الوظيفي (الاستثمار أو الإقراض مثلا) ؟ .

( ) مهمة جداً .
( ) مهمة .
( ) إلى حد ما مهمة .
( ) مهمة بشكل .
( ) غير مهمة .

س7- عند إستخدامك للقوائم المالية التى تمت مراجعتها لغرض إتخاد قرارات (مثلا: إقراض أو استثمار) هل تراعي عدالة القوائم المالية ؟.

( ) دائماً
( ) في الغالب
( ) أحياناً
( ) نادراً
( ) مطلقاً لا

إذا أجبت (نادراً أو مطلقاً) من فظلك اذهب إلى السؤال رقم 9 أو أجب سؤال رقم 8.

س8- عند تقييمك لمدى عدالة القوائم المالية ماهى وتيرة إهتمامك باستقلالية المراجع الخارجي؟

( ) دائماً
( ) في الغالب
( ) أحياناً
( ) نادراً
( ) مطلقاً لا

إذا أجبت (نادراً أو مطلقاً لا) من فضلك إذهب إلى السؤال رقم 10 أو أجب السؤال رقم 9

س9- لو اعتقدت بأن المراجع الخارجي غير مستقل ، كيف يؤثر ذلك على ثقتك في عدالة القوائم المالية؟

( ) انخفاض الثقة بشكل كبير
( ) انخفاض الثقة إلى حد ما
( ) ليس لها تأثير على القوائم المالية.

س10- في حالة اتخاذك لقرارات مالية (مثل: الإقراض أو الاستثمار)، ماهى وتيرة مراعاتك لاستقلالية المراجع الخارجي ؟

( ) دائماً
( ) فى الغالب
( ) أحياناً
( ) نادراً
( ) مطلقاًلا

إذا أجبت (د) أو (هـ) أذهب إلى السؤال رقم 12 أوأجب سؤال رقم 11

س11- لو اعتقدت بأن المراجع الخارجي الذي قام بمراجعة حسابات شركة معينة غير مستقل ، كيف يؤثر ذلك على حجم (الإقراض أو الاستثمار) في تلك الشركة؟

( ) تقترض/ تستثمر أكثر

( ) ليس له تأثير

( ) تقترض / تستثمر أقل

( ) لاتقترض ولاتستثمر.

الجزء الرابع :-

العوامل المؤثرة في اسقلالية المراجع الخارجي وعدالة القوائم المالية التي تمت مراجعتها:

الأسئلة من رقم 12 إلى رقم 22 تقدم بيانات مختلفة حول مجموعة عوامل والتي من الممكن أن يكون لها تأثير على استقلالية المراجع الخارجي وكذلك عدالة القوائم المالية من فضلك ارسم دائرة حول الرقم الذي تعتقد هو المناسب في اجابتك.

1= يضعف استقلالية المراجع بشكل قوي ,2 = يضعف استقلالية المراجع ، 3= ليس له تأثير ، 4 = يعزز من استقلالية المراجع ، 5 = يعزز استقلالية المراجع بشكل قوي.

س12- خدمات المراجعة الخارجية تقدم من قبل شركة مراجعة ضخمة.

1. ....2. .... 3. .... 4. .... 5.

س13 - خدمات المراجعة الخارجية تقدم من قبل شركة مراجعة متعددة الجنسية أو ما يعرف بالأربع الكبار

1. ....2. .... 3. .... 4. .... 5.

س14- من خلال قوائم المالية لشركة معينة تبين أن أتعاب المراجعة الخارجية المقدمة من طرف زبون واحد تزيد عن 15 بالمائة من إجمالي دخل شركة المراجعة.

1 ....2.........................3 ....4.......................5

س15- وجود لجنة مراجعة في الشركة محل المراجعة لمتابعة عمل المراجع الخارجى والإدارة.

1 ....2.........................3 ....4. 5

س16- المراجع الخارجى يقوم بتقديم خدمات استشارية ومالية لعملائه .

1.....................2.........................3.........................4.........................5

س17- المراجع الخارجي يقوم بتقديم خدمات استشارية ومالية لغير عملائه.

1.....................2.........................3.........................4. 5

س18- تدوير المراجع كل خمس سنوات (بحيث لايستمر في تقديم خدمات المراجعة لنفس العميل لمدة أطول)

5.....................4.......................3.......................2....................1

1= يضعف استقلالية المراجع بشكل قوي ,2 = يضعف استقلالية المراجع ، 3 = ليس له تأثير ، 4 = يعزز من استقلالية المراجع ، 5 = يعزز استقلالية المراجع بشكل قوي.

س19- عدم وجود تشريعات أو ضوابط قانونية للمحافظة على استقلالية المراجع الخارجي .

5...................... .4 .... .3 .... .2......................1

س20- غياب معايير محلية للمراجعة والمحاسبة (معيارالاستقلالية المحلي).

5...................... .4 .... .3 .... .2......................1

س21- تقديم خدمات مراجعة في بيئة مراجعة تنافسية عالية.

5...................... .4 .... .3 .... .2......................1

س22-تقديم خدمات مراجعة من قبل شركة أو مكتب محاسبة صغير الحجم .

5.......................4 .... .3 .... .2.........................1

الأسئلة من رقم 23 إلى رقم 32 تقدم مجموعة من حالات المراجعة في كل حالة من فضلك ارسم دائرة حول الرقم الذى يعبر عن مدى عدالة القوائم المالية.

1 دائما عادلة ، 2 = في الغالب عادلة ، 3 = أحيانا عادلة، 4 = نادرا ما تكون عادلة ، 5 = غير عادلة على الإطلاق.

س23- من خلال القوائم المالية للشركة التي تمت مراجعتها لاحظت بأن المراجعة قدمت من قبل:-

القوائم المالية تعبر عن عدالة المركز المالى للشركة

(أ) شركة المحاسبة العملاقة (الاربع الكبار) 1.................2.................3.................4.................5

(ب) شركة مراجعة محلية. 1.................2.................3.................4.................5

س24- مراجعة القوائم المالية تمت في :-

(أ) بيئة مراجعة ذات تنافسية عالية . 1.................2.................3.................4.................5

(ب) بيئة مراجعة ذات تنافسية منخفضة 1.................2.................3.................4.................5

س25- من خلال القوائم المالية للشركة التي تمت مراجعتها لاحظت بأن الشركة:-

(أ) لديها لجنة مراجعة. 1...............2...............3...............4...............5

(ب) ليس لديها لجنة مراجعة 1...............2............... 3...............4...............5

س26- علمت بأن خدمات استشارية مالية تقدم للعميل من قبل : -

(أ) مراجعون يقومون بتقديم خدمات مراجعة خارجية للعميل. 1...............2...............3...............4...............5

(ب) مراجعون (قسم أخر بالشركة) أخرون يقدمون خدمات استشارية للعميل 1............... 2...............3...............4...............5

(ج) شركة مراجعة أو مراجع خارجي خارج شركة المراجعة. 1...............2...............3...............4...............5

(د) المراجع لكل عملائه ولكن إفصاح كامل يتم بالقوائم المالية للعميل. 1...............2...............3...............4...............5

س27- علمت بأن الشركة تتم مراجعتها من قبل نفس مكتب المراجع الخارجى لفترة.

(أ) 10 سنوات 1.................2.................3.................4.................5

(ب) 5 سنوات 1.................2.................3.................4.................5

(ج) أقل من 5 سنوات 1.................2................. 3.................4.................5

1 دائما عادلة ، 2 = في الغالب عادلة ، 3 = أحيانا عادلة، 4 = نادرا ما تكون عادلة ، 5 = غير عادلة على الإطلاق.

القوائم المالية تعبر عن عدالة المركز المالى للشركة

س28- علمت بأن الشركة تتم مراجعتها من قبل نفس المراجع" زميل مهنة" عن عملية المراجعة لفترة.

(أ) 10 سنوات 1..............2..............3..............4..............5

(ب) 5 سنوات 1..............2..............3..............4..............5

(ج) أقل من 5 سنوات 1..............2..............3..............4..............5

س29- علمت بأن الشركة تتم مراجعتها من قبل نفس مدير المراجعة المسؤل عن عملية المراجعة لفترة.

(أ) 10 سنوات 1..............2..............3..............4..............5

(ب) 5 سنوات 1..............2..............3..............4..............5

(ج) أقل من 5 سنوات 1..............2..............3..............4..............5

س30- خدمات المراجعة قدمت للشركة في بيئة :-

(أ) تفتقر إلى تشريعات وضوابط قانونية تحافظ على استقلالية المراجع 1..............2..............3..............4..............5

(ب) ذات تشريعات وقوانين قوية للمحافظة على استقلالية المراجع . 1..............2..............3..............4..............5

س31- من خلال القوائم المالية للشركة لاحظت بأن :-

(أ) أتعاب المراجعة من عميل معين تزيد عن 15 بالمائة من إجمالي دخل أتعاب المراجعة. 1..............2..............3..............4..............5

(ب) أتعاب المراجعة من عميل معين لا تزيد عن 15 بالمائة من إجمالي دخل أتعاب المراجعة 1..............2..............3..............4..............5

س32- بعد اطلاعك على القوائم المالية للشركة علمت بأنه :-

(أ) توجد علاقة إجتماعية بين المراجع وإدارة الشركة.

(ب) لا توجد علاقة إجتماعية بين المراجع وإدارة الشركة.

الجزء الخامس:- استقلالية المراجع وخلافات المراجعة.

الاسئلة من 33-36 للمراجعين فقط

س33- هل سبق لك أى خلاف مع عميلك (مدير أو وكيل شركة)

( ) نعم **( )** لا

س34- إذا أجبت بنعم ، ماهي الاسباب التى أدت إلى الخلاف .(إختر كل أو بعض الاجابات التالية):

( ) اكتشفت معالجة محاسبية غير صحيحة .
( ) تبين التغيير في تطبيق القواعد المحاسبية والتى بدورها تؤدى إلى اختلافات مادية في الدخل.
( ) إفصاح غير كافٍ في بعض بنود القوائم المالية .

( ) عدم تسجيل عملية مالية والتى يترتب عليها أثر مادي على القوائم المالية.
( ) إدارة الشركة لم تلتزم بالموعد المتفق عليه في جدول المراجعة الزمني.

س35- هل سبق لك تقديم تقرير مراجعة سلبي ؟

( ) نعم ( ) لا

س36- هل تقديم مثل هذا التقرير ينتج عنه فقدان العميل ؟

( ) نعم ( ) لا

الأسئلة من 37-40 لمدراء المؤسسات المالية فقط

س37- هل سبق لك وأن اختلفت مع المراجع الخارجي للقوائم المالية

( ) نعم ( ) لا

س38- إذا أجبت بنعم ، ماهى الاسباب التى أدت إلى ذلك الخلاف . (اختر بعض أو كل الاجابات التالية)

( ) الضغط الزمني الذى سببته بعض التعديلات في القوائم المالية
( ) التغيير في تطبيق القواعد المحاسبية الذى ينجم عنه اختلاف في ناتج الدخل
( ) إفصاح غير كاف في بعض بنود القوائم المالية
( ) عدم تسجيل عملية أو عمليات مالية التى يترتب عليها أثر مادي على القوائم المالية
( ) المرونة في اتباع القواعد والمبادى المحاسبية.

س39- هل سبق لك الحصول على تقرير سلبي من قبل المراجع الخارجي؟

( ) نعم ( ) لا

س40- هل استلامك مثل هذا التقرير ينتج عنه تغيير المراجع الخارجي ؟

( ) نعم ( ) لا

الجزء السادس :- أهمية تقرير المراجعة لكل مستخدمي القوائم المالية والمراجعين:

السؤال 41 يرجى التفضل برسم دائرة حول الرقم المناسب على المؤشر من 1 إلى 5
1= مهم جداً 2= مهم 3= لا اجابة 4= غير مهم 5= غير مهم على الإطلاق

س41- إلى أي مدى يعتبر تقرير المراجع الخارجى مهم ؟

1. ....2. .... 3. .... 4. .... 5.

الجزء السابع :- تأثير العلاقات الاجتماعية على استقلالية المراجع الخارجي :

س42- هل تعتقد أن العلاقات الاجتماعية لها تاثير على عمل المراجع .

( ) نعم ( ) لا

س43- إذا أجبت بنعم إلى أي مدى تؤثر العلاقات الاجتماعية في استقلالية المراجع أثناء قيامه بعمله. ضع دائرة حول الرقم المناسب

1= تضعف استقلالية المراجع بشكل قوي ، = تضعف استقلالية المراجع ، 3= ليس لها تأثير ، 4 = تعزز من استقلالية المراجع ، 5 = تعزز استقلالية المراجع بشكل قوي.

1.................................2.................................3.................................4.................................5

س44- الرجاء استخدام هذه المساحة لإبداء أرائكم وتقديم أية ملاحظات أو تعليقات ترونها ضرورية حول كل ما ورد بهذا الاستبيان .

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<u>شكراً جزيلاً . إنتهت الأسئلة.</u>

Appendix 11: Foreign companies operating in Libya

Libyan economy has witnessed significant growth following the lifting of the economic sanctions that were imposed on the country, due to political conflict with USA, by the UN council. In addition, Libya recently has changed its political attitude toward the international community, by abandoning the production of Weapons of Mass Destruction (WMD) and settling other legal compensations with the USA. These developments have led to improving business ties with the UK, USA and other foreign companies. For instance, Bosley (2009) reports that the foreign companies, the majority are specialised in the oil and gas industry, which are investing in Libya are as follows:

- The British firm BP in 2007signed its biggest-ever exploration commitment through a bilateral deal. It will spend at least $900 million to search exploration wells. While Royal Dutch Shell, the London-listed company, was awarded a gas exploration permit in 2007.
- ExxonMobil signed in 2008 a deal to invest $97 million plus tens of millions in fees in offshore hydrocarbon exploration.
- The Canadian Verenex company is the only winner of post-sanctions licenses under Libya's EPSA-IV tender mechanism to have made sizeable finds, prompting a battle for ownership of the company between Libya and China National Petroleum Corp.
- Occidental began business in Libya in 1966, reported first-quarter 2009 net production from Libya of 8,000 barrels per day, down from 22,000 bpd a year earlier. In late 2007 it won gas-focused permits to explore areas of the Sirte basin, and in 2005 was the biggest winner in Libya's first licensing round.
- PGNiG -Libya's state-owned oil corporation ratified a gas exploration agreement in February 2008 with the Polish gas monopoly for drilling at least eight wells at a cost of $108 million in the Murzuq Basin.
- The Russian Gazprom company was awarded a gas exploration license in 2007 for areas in the Ghadames Basin.
- The German RWE energy firm agreed to spend at least $76 million and drill two exploration wells in Syrenica basin blocks it won access to in late 2007.
- The Algerian Sonatrach state energy firm won blocks in the Ghadames Basin in December 2007.

- Oasis Group, which is the group of ConocoPhillips, Amerada Hess and Marathon agreed to pay Libya $1.3 billion to extend their contracts in the Sirte Basin. The contracts were concluded before the sanctions were imposed, but the U.S. companies left Libya in 1986 after U.S. sanctions were imposed.
- Nippon Oil which is Japan's largest refiner in 2005 struck an offshore exploration and production-sharing agreement with Libya that also includes Mitsubishi Corp. and Japan Petroleum Exploration (JAPEX), which said it would invest $48 million in exploration over five years.
- The Brazilian Petrobas company was awarded licenses for exploring offshore in January 2005.
- Another foreign company which is doing business with Libya is BNP Paribas which Bought a 19 per cent stake and strategic partnership in Sahara Bank for $145 million in 2007, during the first partial privatisation deal for Libya.