



EDUCATION

By my Father, Mother, FPA, Brothers and Sisters

**An Investigation into the Perception of Oil Companies and Audit
Firms on Factors Affecting Service Quality of Auditing**

**A thesis submitted in fulfillment of the requirements for the degree of
Doctor of Philosophy of the Business School, Liverpool John Moores
University**

By,

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DEDICATION

To my Father, Mother, Wife, Brothers and Sisters

ABSTRACT

Audit quality has been a focus of interest and research in advanced countries such as the UK and US for several decades given the role of auditors' reports in the decision-making process used by investors. Arguably, emerging markets, such as that in Libya, do not enjoy the same level of audit quality as developed markets, and this poses a dilemma for both investors, and those seeking to attract investors. This study explores that problem from the perspective of oil companies and audit firms in Libya, with a view to recommending a framework for audit quality in Libya.

As a means of investigation, five themes were examined: size of the audit firm, the provision of non-audit services (NAS), the length of auditor tenure, level of competition in the audit market, and fees for audit services. The research population, reached through a questionnaire survey and interview sample, came from both the demand and supply sides (Libyan oil companies, and audit firms working in Libya). Participants were asked to comment on their perceptions of the influence of the five themes on audit quality in Libya. The findings showed that respondents were not sufficiently satisfied with the current level of audit quality in Libya, and expressed dissatisfaction with the role of the LAAA as one intended to enhance the level of audit quality.

Regarding the five themes pursued, this study revealed that a positive association exists between the size of the audit firm and audit quality, and that Big Four audit firms were considered to be superior to other audit firms. Such superiority was seen in relation to resources and audit technology, and the consequent motivation to perform as professionally as possible.

The provision of NAS to audit clients was found to provide auditors with greater experience of the client's industry and greater access to the client's accounting system. Additionally, such an arrangement was considered to enhance audit quality, but simultaneously it was also believed that a separation of NAS from audit services was desirable since auditors are perceived to have greater credibility when the demarcation is clear.

Auditor tenure was found to be influential in as much as a long relationship was believed to impair the independence of the auditor, and consequently impact negatively on the level of audit quality. Mandatory rotation was seen to be positively associated with audit quality, leading to a dilution of any relationship between the client and auditor.

Competition within the Libyan audit market was found to be high but this was not believed to impact unfavourably on audit quality.

Finally, a positive relationship exists between audit fees and audit quality. It was perceived that a firm charging high fees spends more audit hours with its clients and, hence, has a greater opportunity to provide high audit quality. It was seen that both audit fees and audit hours were influenced by audit quality, and that audit hours and audit quality were higher among initial audits.

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TABLE OF CONTENTS

Dedication	I
Abstract	II
Acknowledgement	III
Table of Contents	IV
List of Tables	VIII
List of Figures	IX
List of Abbreviations	X
CHAPTER ONE : INTRODUCTION	
1.1 : Introduction	1
1.2 : Aims and Objectives of the Study	6
1.3 : Research Questions	7
1.4 : Statement of the Problem	7
1.5 : The Research Methodology	8
1.6 : Contribution to Knowledge	12
1.7 : Conference Presentations Based on the Thesis	15
1.8 : Structure of the Thesis	16
CHAPTER TWO: AN OVERVIEW OF THE LIBYAN ENVIRONMENT	
2.1 : Introduction	20
2.2: Brief Historical Background	21
2.2.1: Geography and Population	21
2.2.2: Pre-and Post-independence Libya	23
2.3: The Libyan Environment and its Accounting Practices	25
2.4 : Political and Economic Influences	27
2.5 : Libya as a Developing Country	32
2.6 : Social and Cultural Influences	34
2.7 : The Libyan Oil Sector	35
2.7.1: The Libyan Oil Economy	36
2.8 : The State of Accounting and Auditing Profession in Libya	38
2.8.1: Libyan Accounting Education and Academic Research	40
2.8.2: Accounting Professional Body in Libya	46
2.8.2.1: Registration as Chartered Accountant in Libya	46
2.8.3: The Libyan Commercial Code	48
2.8.4: Tax Law	49
2.9 : Summary	50
CHAPTER THREE: LITERATURE REVIEW	
3.1 : Introduction	52
3.2 : Definition of Auditing	52
3.3 : The Importance of Auditing	54
3.4 : The Demand for Auditing Services	55
3.5 : Objectives of External Auditing	59

3.6 : Audit Quality	60
3.6.1 : Definition of Audit Quality	61
3.6.2 : Auditor Independence and Audit Quality	63
3.6.3 : Auditor Attributes and Audit Quality	67
3.7 : Factors Impairing and Enhancing Audit Quality	69
3.7.1 : Size of the Audit Firm	69
3.7.1.1 : Features of Audit Firms	70
3.7.1.2 : Size of Audit Firm and Audit Quality	71
3.7.2 : The Provision of Non-Audit Services (NAS)	82
3.7.2.1 : Definition of Non-Audit Services (NAS)	82
3.7.2.2 : Arguments against the Provision of Non-Audit Services	84
3.7.2.3 : Arguments in Favour of the Provision of Non-Audit Services	89
3.6.2.4 : The Provision of Non-Audit Services (NAS) and Audit Quality	92
3.7.3 : Length of Audit Tenure	97
3.7.3.1 : Length of Audit Tenure and Notion of Mandatory Audit Rotation	97
3.7.3.2 : The Benefits of Mandatory Audit Rotation	98
3.7.3.3 : The Drawbacks of Mandatory Audit Rotation	99
3.7.3.4 : Length of Audit Tenure and Audit Quality	102
3.7.4 The Level of Competition in the Audit Market.	111
3.7.5 Fees for Audit Services	119
3.7.5.1 Fees for Audit Services and Audit Quality	119
3.7.5.2 Fees for Audit Services in Developed Countries	122
3.7.5.3 Fees for Audit Services in Developing Countries	127
3.8 Implications of the Literature for Libya	128
3.9 Study Aims and Objectives	129
3.10 Summary	129
CHAPTER FOUR: RESEARCH METHODOLOGY	
4.1 : Introduction	134
4.2 : Research and Philosophical Assumptions	134
4.3 : Methodology and Data Collection	138
4.3.1 : Quantitative Research Method	139
4.3.2 : Aims and Objectives of the Study	139
4.3.3 : Research Questions	140
4.3.4 : The Questionnaire Method	142
4.3.5 : Types of Questionnaire	141
4.3.5.1 : Telephone Interviewing	143
4.3.5.1.1 : Advantages of the Telephone Interviewing	143
4.3.5.1.2 : Disadvantages of the Telephone Interviewing	143
4.3.5.2 : Mailed Questionnaires	144
4.3.5.2.1 : Advantages of the Mailed Questionnaires	144
4.3.5.2.2 : Disadvantages of the Mailed Questionnaires	145
4.3.5.3 : Personally-administered Questionnaires	146
4.3.5.3.1: Advantages of the Personally-administered Questionnaires	146

4.3.5.3.2:Disadvantages of the Personally-administered Questionnaires	146
4.4 : Relevance of Questions to the Research Objectives	147
4.4.1 : The Wording of Questions	147
4.4.2 : The Sequence and Flow of Questions	149
4.4.3 : The Type of Questions	149
4.4.4 : Scaling Process	151
4.5 : The Questionnaire Design	152
4.6 : The Pilot Procedures in Respect of the Questionnaire	153
4.7 : Instrument Reliability and Validity	156
4.7.1 : Validity	157
4.7.2 : Reliability	157
4.8 : The Sampling Unit and Questionnaire procedure	158
4.9. : The Response Rate	160
4.10 : Qualitative Research Method	162
4.10.1 : Interviews	163
4.10.1.1 :Semi-structured Interviews	164
4.10.1.2 : Advantages of the interview method	165
4.10.1.3 : Disadvantages of the interview method	165
4.11 : The Sampling Unit and Interview Procedures	166
4.12 : Interview Analysis	169
4.13 : Questionnaires versus Interviews	172
4.14 : Statistical Analyses Employed	173
4.14.1 : Descriptive and Analytical Statistical Methods	176
4.15 : Triangulation	178
4.16 : Summary	179
CHAPTER FIVE: QUANTITATIVE FINDINGS	
5.1 :Introduction	180
5. 2 :Analysis of Section A of the Questionnaire: General Information	181
5.3 :Analysis of Section B of the Questionnaire	185
5.3.1 : The Current Perception of Audit Quality in Libya	185
5.3.1.1 : The Current Perceptions of Audit Quality Based on Position	189
5.3.1.2 : The Current Perceptions of Audit Quality Based on Type of Audit Firm	192
5.4 : Analysis of Section C of the Questionnaire: Factors Impairing and Enhancing Quality	194
5.4.1 : Size of the Audit Firm	194
5.4.1.1 : The Perceptions of Size of Audit Firm Based on Position	199
5.4.1.2 : The Perceptions of Size of Audit Firm Based on Type of Audit Firm	201
5.4.2 : The Provision of NAS	204
5.4.2.1 : The Perceptions of NAS Based on Position	209
5.4.2.2 : The Perceptions of NAS Based on Type of Audit Firms	211
5.4.3 : The Length of Audit Tenure	213
5.4.3.1 : The Perceptions of Length of Audit Tenure Based on Position	218
5.4.3.2 : Perceptions of Length of Audit Tenure Based on Type of	221

Audit Firm	
5.4.4 : The Level of Competitiveness in the Audit Market	224
5.4.4.1 : The Level of Competition in the Audit Market Based on Position	226
5.4.4.2 The Level of Competition in the Audit Market Based on Type of Audit Firm	226
5.4.5 : Fees for Audit Services	228
5.4.5.1 : Fees for Audit Services Based on Position	233
5.4.5.2 : Fees for Audit Services Based on Type of Audit Firm	233
5.5 : Analysis of Section D of the Questionnaire	236
5.5.1 : Future Development of Audit Quality in Libya	236
5.5.1.1 : Future Development of Audit Quality in Libya Based on Position	241
5.5.1.2 : Future Development of Audit Quality in Libya Based on Type of Audit Firm	244
5.6 : Summary	247
CHAPTER SIX: QUALITATIVE FINDINGS	
6.1 : Introduction	251
6.2 : Objective of interviews	251
6.3 : Key outcomes from interviews	252
6.4 : Interview Results	253
6.4.1 : Demographic Information to Interviewees	254
6.4.2 : The Current Perception of Audit Quality in Libya	255
6.4.3 : Factors Enhance and Impairing Audit Quality	259
6.4.3.1 : The Size of Audit Firm and Audit Quality	260
6.4.3.2 : Provision of NAS and Audit Quality	266
6.4.3.3 : The Length of Auditor Tenure and Audit Quality:	270
6.4.3.4: The Level of Competition in the Audit Market and Audit Quality	274
6.4.3.5 : Fees for Audit Services and Audit Quality	277
6.4.4 : The Future Development of Audit Quality in Libya	280
6.5 : Summary	282
CHAPTER SEVEN: CONCLUSION AND RECOMMENDATIONS	
7.1 : Introduction	286
7.2 : Summary and Review of Findings	287
7.2.1: The Current Perceptions of Audit Quality in Libya	288
7.2.2 : Factors Enhance and Impairing Audit Quality	290
7.2.3 : Potential Improvements to the Libyan Auditing Environment	298
7.3 : Recommendations of the study	299
7.4 : Limitations of the Research	302
7.5 : Suggestions for Future Research	303
7.6 Overall Conclusion	304
BIBLIOGRAPHY	305
APPENDICES	334

LIST OF TABLES

Table 2.1: Libyan Exports in the Period 1996-2005	37
Table 4.1: Questionnaire Survey Response Rate	162
Table 4.2: Interviews at the Libyan Oil Companies and Audit Firms	169
Table 5.1: The Gender of Respondents	181
Table 5.2: The Age of Respondents	182
Table 5.3: The Position of Respondents	182
Table 5.4: The Experience Levels of Respondents	183
Table 5.5: Academic Qualifications of Respondents	183
Table 5.6: The Professional Qualifications of Respondents	184
Table 5.7: Types of Audit Firms	184
Table 5.8: Percentage of Respondents who Received or Provided Non-Audit Services	185
Table 5.9: Distribution of Evaluations of Different Statements Regarding the Current Perception of Audit Quality in Libya	187
Table 5.10: Distribution of Different Statements Regarding the Current Perception of Audit Quality Based on Position	191
Table 5.11: Distribution of Different Statements Regarding the Current Perception of Audit Quality Based on Type of Audit Firm	193
Table 5.12: Distribution of the Evaluations given by the Different Statements Regarding the Size of Audit Firm and Audit Quality	198
Table 5.13: Distribution of Different Statements Regarding the Size of Audit Firm Based on Position	200
Table 5.14: Distribution of Different Statements Regarding the Size of Audit Firm Based on Type of Audit Firm	203
Table 5.15: Distribution of the Evaluations given by the Different Statements Regarding the Non-Audit Services (NAS) and Audit Quality	208
Table 5.16: Distribution of the Evaluations given by the Different Statements Regarding the Non-Audit Services (NAS) based on Position	210
Table 5.17: Distribution of the Evaluations given by the Different Statements Regarding Non-Audit Services (NAS) based on Type of Audit Firm	212
Table 5.18: Distribution of the Evaluations given by the Different Statements Regarding the Length of Audit Tenure and Audit Quality	217
Table 5.19: Distribution of the Evaluations given by the Different Statements Regarding the Length of Audit Tenure based on Position	220
Table 5.20: Distribution of the Evaluations given by the Different Statements Regarding the Length of Audit Tenure based on Type of Audit Firm	223
Table 5.21: Distribution of the Evaluations given by the Different Statements Regarding the Competition in the Audit Market and Audit Quality	225
Table 5.22: Distribution of the Evaluations given by the Different Statements Regarding the Competitive Market based on Type of Audit Firm	227
Table 5.23: Distribution of the Evaluations given by the Different Statements Regarding the Fees for Audit Services and Audit Quality	232
Table 5.24: Distribution of the Evaluations given by the Different Statements Regarding the Fees for Audit Services Based on Type of Audit Firm	235
Table 5.25: Distribution of the Evaluations given by the Different Statements	240

Regarding the Future Development of Audit Quality in Libya	
Table 5.26: Distribution of the Evaluations given by the Different Statements Regarding the Future Development of Audit Quality Based on Position	243
Table 5.27: Distribution of the Evaluations given by the Different Statements Regarding the Future Development of Audit Quality Based on Type of Audit Firm	246
Table 6.1: The Number of Interviews at the Libyan Oil Companies and Audit Firms	254
Table 6.2: The Experience Levels of Respondents.	254

LIST OF FIGURES

Figure 1.1: Structure of the Thesis	19
Figure 3.1: The Demand for Monitoring	58
Figure 3.2: The Relationship between Audit Firm Characteristics and Auditor Independence and Audit Quality	67
Figure 3.3: Power in Withstanding Pressure Based on Audit Firm and Auditee Characteristics	80
Figure 3.4: Tenure-Audit Quality Framework	104

LIST OF ABBREVIATIONS

ACCA	Association of Certified and Corporate Accountants
ACIA	Association of Chartered Incorporated Accountants
AICPA	American Institute of Certified Public Accountants
ASCA	Arab Society of Certified Accountants
CIMA	Chartered Institute of Management Accountants
CIPFA	Chartered Institute of Public Finance and Accountancy
EU	European Union
GAAPs	Generally Accepted Accounting Principles
GAASs	Generally Accepted Auditing Standards
GAO	General Accounting Office
GPC	General People's Committee
IAS	International Accounting Standards
ICAEW	Institute of Chartered Accountants of England and Wales
IFA	International Federation of Accountants
ISA	International Standards on Auditing
ISAR	International Standards of Accounting and Reporting
KW	Kruskal-Wallis test
LAAA	Libya Accountants and Auditing Association
NAS	Non-Audit Services
NOC	National Oil Corporation
OPEC	Organization for Petroleum Exporting Countries
PwC	PricewaterhouseCoopers
SEC	Securities and Exchange Commission
SOA	Sarbanes-Oxley Act
SPLAJ	Socialist People's Libyan Arab Jamahiriya
SPSS	Statistical Package for Social Sciences
WTO	World Trade Organisation

CHAPTER ONE

INTRODUCTION

1.1 Introduction

There are many definitions of the term 'Audit Quality' that are usually changed in accordance with the parties involved in it. DeAngelo (1981a) asserts that Audit Quality refers to the market-assessed joint probability that an auditor discovers and reports material financial statement errors. Similarly, according to Epstein and Geiger (1994), 70% of investors believe that an audit should provide absolute assurance that there are no material misstatements or fraud in financial statements. Indeed, as auditors are subject to litigation that might follow a bad audit when assessing business risk, it can be assumed that they would act with the utmost professionalism, as a means of protecting themselves. However, over the last decades, the Anglo Saxon world has experienced a spate of corporate failures, financial scandals and audit failures, which have placed the audit quality debate firmly on the agenda of the accounting profession, regulators and the public. Certainly, there has been widespread concern for some time among regulators about audit quality (see, for example: DeAngelo, 1981a; Knapp, 1991; Arrunada, 1999, 2000; Carey, 2006; Clark, 2007).

Since the outcome of audit quality is unobservable, it is very difficult to measure it (Wooten, 2003). That said, there have been many attempts on the part of researchers who have identified certain attributes that are displayed in financial statements (see, for example: Knapp, 1991; Behn et al, 1997; Wooten, 2003).

Considering the literature on the same topic, a significant amount of theoretical and empirical research has been devoted to defining the nature and extent of the relationship between the different variables of audit quality and the level of audit quality, such as size of the audit firm, the provision of non-audit services (NAS), the length of auditor tenure, the level of competition in the audit market, and the fees for audit services.

In respect of audit firms, DeAngelo (1981a) has highlighted that size may be influential in promoting audit quality, Big Eight, and other large audit firms appear to be more able to detect inaccuracies than small audit firms, and more frequently report these. In 1998, Becker et al consistently found that the then Big Six (becoming the Big Four in 2002) auditors were more likely to spot anomalies and refuse to accept the use of extreme accruals, or even qualify the audit report, than their counterparts in smaller audit firms. However, being a large audit firm is not a cast iron guarantee of quality, as has been observed in the cases of Enron and WorldCom, which whilst being exceptions, do nonetheless leave room for the argument that firm size and audit quality are not related, as proposed by Imhoff (1988). Indeed, Chandler (1991) has added weight to this position, suggesting that it quality might be a feature of individual auditors rather than the size of the firm they work for.

Whether firm size has a bearing or not, the degree of familiarity with an audit client is definitely believed to impair the auditor's ability to be completely detached, and in this respect, the provision of non-audit services (NAS) is believed to have the potential to undermine audit quality. In this respect, auditor independence is brought into question because of the possibility that

auditors may actually audit their own work, and simultaneously forge interests that coincide with those of management (Panel on Audit Effectiveness, 2000). The opposing argument, however, is that by providing NAS to its clients, audit firm gains the potential to enhance its knowledge about the client, thus being in a better position to discover problems. Hence, NAS may increase audit quality provided that there is sufficient demarcation between the parties performing the different types of service. Furthermore, a client who purchases both audit and NAS from one firm, may have an increased dependence on its auditor, thus minimising the possibility of the switch threat (see, for example: Abdel-Khalik, 1990; Craswell, 1999; DeFond et al, 2002). Given these opposing perspectives, it is not surprising that the debate surrounding the provision of both audit and NAS to audit clients attracts many contributors, and extensive argument has been reported in this respect (see, for example: Craswell, 1999; Beattie and Fearnley, 2002; Abu Bakar et al, 2005; Hay et al, 2006; Chung and Kallapur, 2003; Mitra, 2007).

Auditors may also acquire a deep understanding of their clients' businesses as a result of long tenure, and hence be in a better position to produce a quality audit. The argument in this respect is that too short a period of engagement does not allow for a proper understanding of the business being audited to be gained, and therefore, the likelihood that audit quality will suffer is a distinct possibility. However, it is also noted that auditors who have been engaged for a very long time may become complacent, miss errors (Burton and Roberts, 1967; Shockley, 1982), and become less independent (DeAngelo, 1981b; Mautz and Sharaf, 1961). The rotation of auditors has thus been implemented in many audit environments as a quality assurance mechanism. At the same

time, however, it is also suggested that periodic rotation might actually be damaging to audit quality (see, for example: Hoyle, 1978; Myers et al, 2003).

Another serious consideration in recent years, has been the fee income received by audit firms from clients who purchase both audit and NAS from them, since where the NAS fees are high, there is a strong incentive for audit firms to want to retain such clients, and hence, the audit process may be conducted with less rigour in the interests of pleasing the client (Levitt 1996)

Finally, there is also a debate concerning the potential influence of the market, whether this be competitive or otherwise, on the quality of audit services offered by firms. In this respect, it is accepted that in a competitive market, firms that do not offer a quality product will not survive, and therefore, the economic theory that competition drives quality is applied to the argument.

Regardless of the possible influences on the audit process, however, over the years, society has acknowledged the value added from audits of publicly-held companies, since they provide assurance to different groups of users of financial statements. As noted by Sherer et al (1997), the audit function is the main mechanism for providing such reassurance. This kind of reassurance is required because the widening segregation between ownership and management, promotes a potential conflict of interest between shareholders and management concerning financial statements. Since financial statements are one of the means used to evaluate management's performance, managers could misrepresent the information contained within them. Moreover, the users of financial statements are interested to know the actual financial position of the audited entity, and not what the entity might like it to be. Additionally,

reassurance is needed because there are increasing concerns about the quality of audit services, resulting in the main, from the recent corporate failures. In this respect, Clark et al (2007) argue that the corporate collapses such as those of Enron, WorldCom and Parmalat, result in the media and regulators paying more attention to the adequacy of corporate governance and audit quality.

The key role of the audit function is to report whether the financial statements of entities show a true and fair view to the users of financial statements, who include investors, creditors, taxation authorities, and clients, all of whom generally rely on the information contained within these documents when making their business decisions. Gaffney et al (1991) confirm this, arguing that the primary purpose of audit reports is to inform users of the level of confidence that can be placed in a set of financial statements. Thus, the auditor adds value because management's representations on its performance and stewardship are examined and reported by an expert outside the management's control.

However, despite the important role of the auditor, some aspects of the auditing function are still ambiguous and have not received sufficient attention in auditing research, especially in developing countries. One of the important questions regarding the issue of audit value is what levels of audit quality are perceived by financial statement users?

It is accepted that high service quality is the most important driving force for business sustainability in today's competitive global marketplace (see, for example: Shawn and Dana, 2008; Fearnley et al, 2005; Carlzon, 1987; Rust and Oliver, 1994; Al-Mogbel, 2006). The quality of service is a measure of

how well the service level provided matches customer expectations, and in the case of the audit function, this is best determined by the clients of audit firms, since they are able to give unbiased opinions on the level of audit quality, whereas the audit firms themselves are not (Ismail et al, 2006).

1.2 Aims and Objectives of the Study

Given the introductory discussion concerning the audit function and the crucial aspect of quality associated with this, this study aims to obtain an in-depth understanding of the current perceptions of the audit quality level in Libya. The focus of the research is on the concepts of firm size, the provision of non-audit services (NAS), the length of auditor tenure, the level of competition in the audit market, and the fees for audit services. The study will be conducted on both the demand side (Libyan oil companies) and on the supply side (audit firms working in Libya). The research objectives are as follows:

1. To examine the current perceptions of the level of audit quality in Libya from the viewpoint of oil companies and audit firms.
2. To investigate the relationships between selected variables perceived as surrogates of the level of audit quality from the perspectives of Libyan oil companies and audit firms.
3. To identify improvements which could be introduced into the Libyan auditing environment.
4. To make recommendations based on the findings of this study in audit to improve audit quality in Libya
5. To contribute to the literature of auditing.

1.3 Research Questions

In order to achieve the research aims and objectives, which as previously stated are to understand the current perceptions of audit quality in Libya, using firm size, the provision of non-audit services (NAS), the length of audit tenure, the level of competition in the audit market, and the fees for audit services as surrogates for quality, the following research questions have been established.

1. What are the perceptions of the oil company and audit firm respondents of the current level of audit quality in Libya?
2. What are the perceptions of the oil company and audit firm respondents concerning the impact of different sizes of audit firm on audit quality?
3. What are the perceptions of the oil company and audit firm respondents concerning the impact of the provision of NAS on audit quality?
4. What are the perceptions of the oil company and audit firm respondents concerning the impact of long tenure on audit quality?
5. What are the perceptions of the oil company and audit firm respondents concerning the impact of a highly competitive environment on audit quality?
6. Is the level of audit quality reflected by the audit fees?
7. What can be done to improve the Libyan auditing environment?

1.4 Statement of the Problem

The concept of audit quality is very broad, but in general terms, it is perceived that auditing quality depends on the ability of the auditors to carry out a thorough examination of the accounts and detect possible errors or anomalies,

and on their willingness to provide an objective opinion of these accounts. Cautious considerations of these two dimensions and the quality safeguards that are provided by the market are crucial for regulations to be efficient (Arrunada, 2000). In addition, the quality of opinion provided by the audit firm is an important determinant of its long-term survival. However, audit quality is not easy to judge, which makes it particularly sensitive to the behaviour of the individuals who engage in audit work (Herrbach, 2001). In this vein, Ismail et al (2006) state that “audit quality is the probability that the auditor will both discover and report a breach in the client’s accounting system, and this depends on the auditor’s technical capabilities”. In respect of the Libyan market which is the focus of this study, it seems that it is important to observe and analyse the elements of audit quality in the literature. By doing this, and using the outcomes as a basis for a questionnaire exercise with oil companies and audit firms, the study will be able to examine the perceptions and attitudes of oil companies and audit firms that operate in the Libyan market. The literature indicates that there are several elements, which shape the perception of the quality of audit service. Among these are: audit firm size, non-audit services, and the audit tenure in respect of a given client (Ismail et al, 2006).

1.5 The Research Methodology

The first concern for a researcher when preparing to collect data for a study, is which is the best way to gather that data and what methods should be applied for analysis. The prime issue is to ensure that the ideas are pursued in a scientific manner, and that the methods adopted are appropriate for the aims and objectives. This needs some consideration because there is no particular

data collection technique that is effective in every situation, and in the social sciences, data can be obtained in either formal or informal settings, and involve verbal (oral and written), and/or non-verbal acts or responses. The combination of these two types of responses results in four major forms of data collection, these being: observational methods, survey research, secondary data analysis, and qualitative research (Punch, 2005). There are two main approaches to data collection: quantitative and qualitative. Quantitative research follows the positivist philosophy, which implies the application of a numerical approach to the issues under investigation, particularly with respect to data collection and analysis (Denzin and Lincoln, 1994). According to Nachmias and Nachmias (1996), this method relies on hypotheses derived deductively from theory. These hypotheses contain variables that can be measured and analysed using statistical procedures. Nettleton and Taylor (1990) state that through statistical data analysis, quantitative methods provide accurate measurements for social action by explaining the causal relationships between phenomena, and measuring these relationships using objective and systemic criteria.

In contrast, qualitative research follows the phenomenological approach to investigation, which is concerned with the means to increase the richness of data relating to the social processes surrounding a problem being examined (Van Maanen, 1979). According to Nachmias and Nachmias (1996), this method uses inductive reasoning to allow the researcher to generate theories. Thus, the researcher poses questions and the data gathered in response are in the form of words. Bryman (1988) indicated that qualitative research is generally used to provide in-depth insights about the phenomenon under investigation.

This study uses questionnaires and semi-structured interviews, and each of these methods is discussed below, although more detail about these two research instruments appears in Chapter Four.

The questionnaire survey is one of the most commonly used research methods for collecting data, perhaps because of its relative ease of administration and its flexibility, and the type of information gathered by this method varies considerably, depending on the survey's objectives. Most questionnaire surveys are conducted in order to quantify certain factual information, such as to identify the characteristics of a particular group, measure attitudes, and describe behavioural patterns. However, certain aspects of the questionnaire survey may also be qualitative in order to provide causal explanations or explore ideas (Zikmund, 2000).

The questionnaire has the advantage of increasing the generality of the data collected and ensuring greater veracity in respondents' answers (Manson and Bramble, 1978). Moreover, questionnaires are less expensive than other methods, they can produce quick results, they can be completed at the respondent's convenience, they can offer a considered and objective view on the issue, and they can cover a large number of samples.

Likewise, the interview is also a popular technique of data collection in social research. Qualitative studies employ an unstructured form of interviewing, such as intensive interviewing, while quantitative studies employ predominantly structured interviews (Sekaran, 1992). In the structured form, the interview resembles a questionnaire with the difference that it is conducted face-to-face. This type of interview is highly structured and strict procedures

are followed. Interviews can, however, also be completely unstructured, where there is no guidance at all other than the notion that a general theme will be explored, or they can be semi-structured, containing elements of both structured and unstructured interviews. Within this type, questions can be closed or open depending on the research topic and purpose, and type of information sought to achieve the research objectives. Additionally, interviews can be undertaken with groups of people rather than with individuals, and as a result more responses are gathered at the same time. This technique is referred to as the focus group. Another benefit of interviews is that they allow dialogue between the researcher and the interviewee, and this means that valuable information might come forward that would not have done so had there been no conversation.

In order to accomplish the research objectives, focus groups will be used as a pilot study from which to develop the questionnaire. Focus groups are normally associated with a phenomenological methodology, being used to gather data relating to the feelings and opinions of a group of people who are involved in a common situation (Hussey and Hussey, 1997). It is necessary to have firm ideas before conducting focus group exercises, and these will be provided by a review of the literature relating to audit quality.

Two further stages of the fieldwork will be undertaken. The first, after the design of the questionnaire, will be a questionnaire survey with a number of oil companies and audit firms working in Libya, aimed at identifying the main problems concerning audit quality and explaining the relationship between the variables chosen as surrogates for audit quality and the level of audit quality.

The second stage will be a series of structured interviews, which will be carried out after the completion of the first stage and the analysis of the responses to the questionnaire survey. These interviews will be conducted with representatives from both the oil companies and the audit firms. From the use of these two procedures, it is envisaged that sufficient research data will be gathered to fully answer the research questions.

The research study has been designed in such a way that it can easily apply the aspects of audit quality on Libyan samples without the need to specify unnecessary data and analysis. The quantitative approach will be used to help in tracing the concept of audit quality development. Oil companies are used as respondents and all types of service offered by audit firms are examined, for example, tax, secretarial services, and audit services. More details concerning the methodology of the study are presented in Chapter Four.

Audit quality cannot be measured purely by the level of accuracy in the audit performance, and in this respect, the issue of timing is also important. In using Libya, a developing country, as its focus, this study, therefore, takes into account elements of timing in terms of where a country is in its stage of development.

1.6 Contribution to Knowledge

Audit quality is a very important issue in the development process of nations. Many countries throughout the world and especially the developing ones have not yet established their own complete and effective standards for audit quality. Therefore, this study will contribute by presenting features of audit quality that

are suitable as benchmarks in respect of the developing countries. The original aspect of knowledge in this study is the application of the already-existing measures of audit quality in an environment that has never witnessed such practices. Although some of the developing countries do have their own audit systems, they are still far behind and require up-dating and proper implementation. Libya is a rapidly developing country, and this is especially so after the relatively recent political stabilisation and the open policy it has started to adopt in the aim of securing a better future for the nation. Amid these rapid changes and the fact that the country is striving to catch up with the developed nations, good audit quality measures have to be considered because these are an important part of the change process. One outcome of this study will be the identification of certain criteria to be the beginning of such measures in the country, and on which future studies can build.

Taking Libya as a case study limits the scope of the investigation, and hence, provides the opportunity for a tightly-focused and in-depth exploration of audit quality issue. This is necessary since the Libyan auditing profession has only a short history, and the body of literature concerning the relationship between the variables that influence audit quality, refers in the main to observations from developed countries, with just a few examples of practice in the developing world. Consequently, this study with its narrow focus, will contribute to the understanding of audit quality issues in non-western environments in general, and in Libya in particular. Additionally, it will identify opportunities for improvement in audit quality, and at the same time help auditors to improve the auditing profession in the Libyan market. The importance of audit to the developing countries was noted by Epstein and Geiger (1994), who found that

70% of investors believe that the audit should provide absolute assurance that there are no material misstatements or fraud in the financial processes, which is a vital issue for the developing countries, as it is often a condition of foreign aid that all attempts to combat fraud and corruption are made.

When exploring the literature, it can be seen that a substantial amount of theoretical and empirical research has been devoted to defining the nature and extent of the relationship between different variables of audit quality and level of audit quality. Those variables range from audit firm size to the provision of non-audit services, the length of auditor tenure, the level of competition in the audit market, and fees for audit services. The research will contribute to the literature on audit quality by applying those standards to a developing country, Libya.

Another contribution can be seen in the methodological approach of this study. In Libya, it is not common to use more than one research method, whereas this study triangulates data by combining the findings from the questionnaire survey which examines the variables across a large number of cases, with the findings from the interview exercise, which allows for an in-depth investigation of the factors affecting the audit quality. This combination may provide a better explanation of the research problem, which is the main driver for choosing the appropriate research methods rather than concentrating on scoring epistemological points (Burns, 2000). Additionally, the study will provide:

- Empirical evidence on the attitude of auditors in oil companies in Libya.

- An assessment of the influence of the Libyan environment on the issue of audit quality.
- A contribution to the Libyan accounting and auditing literature by providing the first detailed and comprehensive research study on the perception of audit quality.
- A framework that enriches accounting studies in general and audit quality in particular.
- Quality information in respect of improving the audit process in the Libyan market.

1.7 Conference Presentations Based on the Thesis

- (a) The 18th National Auditing Conference, 18th/19th April 2008, Cardiff University.
- (b) Conference on the PhD Experience, Hull University, 17th/18th November 2008.
- (c) Sawan N, Pegum R and McMahon C. An Investigation into the Perception of Oil Companies and Audit Firms on Factors Affecting Auditing Quality in Libya, Salford Postgraduate Annual Research Conference (SPARC), 7th/8th May 2009, Salford University. Presentation based on the main study results.
- (d) Sawan N, Pegum R and McMahon C. An Investigation into Factors Influence on Audit Quality in Libya. The 2nd Annual BLW Research Student Conference, 20th May 2009, Liverpool John Moores University. Presentation based on the main study results.
- (e) Sawan N, Pegum R and McMahon C. The Current Perception of Audit Quality in Libya. The 2nd Academic Symposium of Libyan Students in the UK, 20th June 2009 at the University of Bradford. Presentation based on the main study results.

1.8 Structure of the Thesis

The thesis is divided into the following seven chapters:

Chapter One: introduces the research problem and the purpose of the research. It explains the aims and objectives, identifies the research questions, and provides a summary of the research methodology. It also stresses the significance of the study in terms of its contribution to knowledge, and indicates the dissemination of information it has yielded so far to the wider academic community. Finally, the general structure of the study is provided.

Chapter Two: presents an overall study of the auditing profession in the Libyan environment, and is divided into three parts. The first part considers the role of accounting in the environment, together with a brief review of the historical background, population and climate of Libya. Libya's history, its position as a developing country, and some aspects of Libya's culture are highlighted in this section. The second part focuses on the Libyan oil sector, and the Libyan oil economy. The third part is devoted to the auditing profession in Libya and includes: a presentation of the history of accounting in Libya, a consideration of the nature of accounting education in Libyan universities, and an examination of the regulatory framework in respect of Libya's auditing profession.

Chapter Three: analyses the extensive literature regarding audit quality, highlighting the various issues associated with it. It begins by focusing on auditing as an activity and pays attention to the definition of auditing, the importance of auditing, and the objectives of external auditing. It focuses

briefly on audit quality, considering definitions of audit quality, and auditor attributes. The chapter then concentrates largely on the empirical literature relating to studies of selected variables, namely, size of the audit firm, the provision of Non-Audit Services (NAS), the length of auditor tenure, the level of competition in the audit market, and the fees for audit services, which are used as surrogates to examine audit quality in various countries.

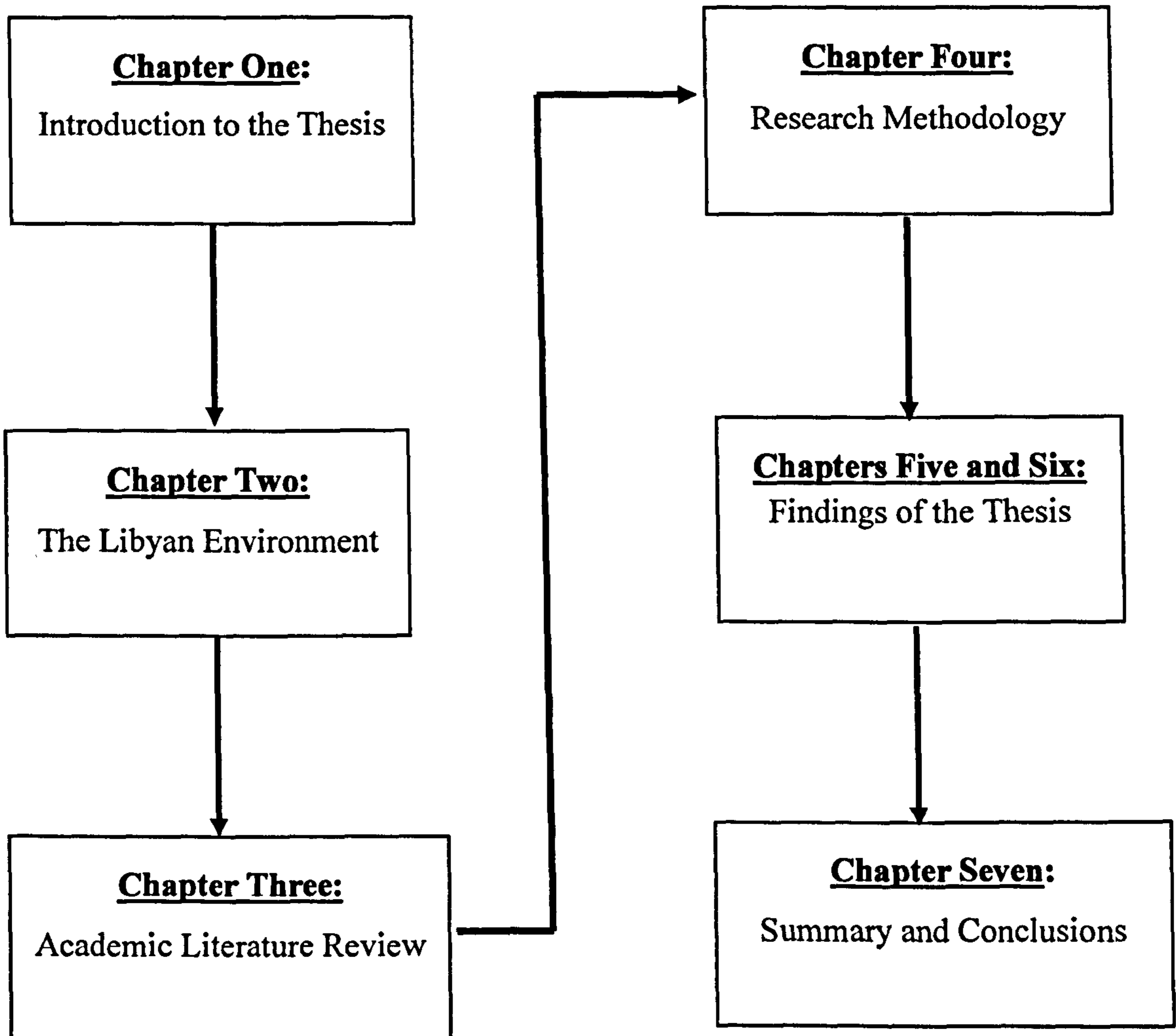
Chapter Four: discusses the methodology adopted to carry out the study and the particular techniques used to gather data. The research objectives, study sample and population details are presented, and a discussion of the philosophical assumptions that guide the research, and thus justify the chosen methodology, is provided. The two methods of data collection (quantitative and qualitative - survey and interview) employed in the empirical fieldwork are discussed in detail, as are other methodological issues, such as the pilot exercise conducted with academic personnel, audit firm staff and with Oil companies' staff in Libya.

Chapter Five: presents the findings of the survey relating to the general perception of audit quality in Libya, conducted with the personnel in Libyan oil companies and audit firms between February to April 2008. It gives a descriptive analysis of the demographic data relating to the two groups of respondents, and then proceeds to reports on the findings of the survey addressing each of the variables in sequence, and presenting the findings in tabular and textual form. Thereafter, the future development of audit quality in Libya is discussed.

Chapter Six: analyses the data collected from the twenty-five interviews conducted in Libyan oil companies (with internal auditors, financial managers, and accounts managers), and audit firms working in Libya (with managing partners, audit supervisors, auditors and regulators working in the LAAA). These findings are analysed and interpreted in order to provide in-depth evidence of the main issues that this study attempts to address. In addition, the findings of the interviews are linked with the questionnaire findings to provide a comprehensive picture of the factors that strengthen audit quality in Libya.

Chapter Seven: provides a summary of the different chapters, focusing on the findings of the study, and the recommendations associated with those. Additionally, the chapter considers the limitations of the study, and presents some guidelines and directions for future research. It concludes the research, asserting that the findings of the study provide important directions for the Libyan government in regulating the audit profession and thereby promoting Libya to foreign investors, not just in the oil sector but in other areas of the economy.

Figure 1.1: Structure of the Thesis



CHAPTER TWO

AN OVERVIEW OF THE LIBYAN ENVIRONMENT

2.1 Introduction

For many decades, the development of the Libyan economy and its population were suppressed by colonial powers such that prior to the discovery of oil in the 1950s the country was backward in comparison with others of similar cultural and religious heritage. Consequently, in comparative terms, it is only fairly recent that Libya has witnessed social and economic development, and this has come about almost entirely as a result of the discovery of oil, and the Socialist Revolution. However, it is undoubtedly the case that since this fortunate turning point in Libya's economic history, growth occurred on a rapid scale since the revenue from oil exportation allowed for the development of a whole range of social services, and other activities such as importing and exporting, agriculture, investment, and new industry. This national progress has, unsurprisingly, resulted in a much greater need for financial information that existed before the 1950s, and in response, an accounting discipline has gradually been evolving in Libya. That said, the economic sanctions imposed on Libya in the 1990s caused a period of stagnation in economic growth, and in the expansion of human capital, such that with the recent economic revival brought about by the removal of sanctions, there is now a heavy demand for policy that ensures the credibility of Libya's accounting profession, seen in the practice of auditors who are able to exercise their independence in the fulfilment of their professional duties. This chapter will, therefore, examine the practice of auditing in Libya.

However, some background detail about the wider Libyan environment is required before considering the accounting profession in detail, since it is accepted that an appreciation of any organisation's relationship to its environment can only be gained by reference to its wider social context (Lowe and Puxty, 1989, cited in Bait-El-Mal, 2000). Consequently, the first task of the chapter is to present a brief review of Libya's history and how it stands today. Thereafter, the chapter is arranged in three major sections. The first addresses the role of accounting in the Libyan environment, the second focuses on the Libyan oil sector, and the third concerns Libya's auditing profession. In the initial section, which addresses the Libyan context, a brief review of Libya's historical background, population and climate of Libya is presented. Included within this review are cultural traditions and the gradual development of the Libyan nation. In the next part, a comprehensive account is offered of the Libyan oil economy. The final part features the history of accounting in Libya, the character of accounting education within the country, an examination of the law pertaining to the auditing profession, and an assessment of research efforts into accounting and auditing. Where suitable, comparisons with some aspects of auditing in the UK are made.

2.2 Brief Historical Background

2.2.1 Geography and Population

Libya is a large country, situated in the middle of North Africa, and covering approximately 1,775,500 sq km (685,524 sq miles). This expanse of territory makes Libya the fourth-largest country in Africa, and one-half the size of Europe. It has a long coastline with the Mediterranean Sea, reaching almost

2,000 km (1,250 miles). However, over 90% of the country is desert or semi-desert, and only 1.5% is fertile. This fertile area is essentially the coastal strip which enjoys a Mediterranean climate, the rest of Libya experiencing a Saharan climate (Attir and Al-Azzabi, 2002).

Algeria and Tunisia are to the west, Egypt and the Sudan to the east, and to the south, Niger, Chad and the Sudan are found. Hence, Libya occupies a strategic position linking Eastern and Western Africa, and Southern Europe with the rest of Africa.

According to the 2005 census, the population of Libya is 6,000,566 (Libyan Secretariat of Economic and Planning, 2007), and there is a high concentration of people in North Western and North Eastern coastal districts in Tripoli and Benghazi, which are Libya's two largest cities. Currently, the population growth rate is 3.5%, believed to be one of the highest rates worldwide, and not surprisingly the vast majority of the population (almost 50%) is young, being less than 20 years old. Again, as expected, given Libya's climatic conditions, the majority of the population (86%) lives in urban areas. This situation gives Libya one of the highest urbanisation rates in the world.

Islam and the Arabic language characterise Libyan culture. Libyans, all of whom are Sunni Muslims, are influenced in all dimensions of life by their emotional attachment to their Islamic faith. That said, Libya's history is one that has attracted many expatriates and at the moment there are over a million foreigners living in the country. Clearly, many of these people have different religions and there are numerous Christian sects, and Indo, Chinese religions

(Attir and Al-Azzabi, 2002), who are all catered for with appropriate places of worship.

2.2.2 Pre- and Post-independence Libya

Libya's history is long and can be traced back 3,000 years, since when various civilisations have flourished in the area, with the Jarmanite civilisation probably being the oldest on Libyan soil (Angelo, 1984). The words 'Libya' and 'Libyan' come from the name of the tribe who lived in North Africa to the west of Egypt. This tribe was known to the Egyptians in the 13th century as the 'Levu' also named the 'Lebu' (Abuarroush, 1996). Actually, the history of this part of the world has been closely related to the history of mankind since the dawn of humanity, and as noted by Humphreys et al (2000:520), Libya's history "has few parallels with the rest of the Middle East".

Many periods of foreign colonisation and military invasion are recorded in Libyan history, since invasions have occurred by the Phoenicians, Greeks, Carthaginians, Ptolemies, Romans, Vandals, Byzantines, Sicilians, Spaniards and the Knights of Malta. Indeed, the three major cities of Tripoli, Leptis Magna, and Sabratha on the western coast were settled by the Phoenicians arriving from Lebanon, while Benghazi and Cyrene on the eastern coast were settled by the Greeks who also made improvements to the already elaborate irrigation system, and in so doing developed agriculture (Fisher, 1990).

Despite such developments, however, the Libyan people suffered the continual oppression of colonisers, and have been left disregarded, deprived, poor and

ignorant. Such circumstances have had a direct effect on the values, mindsets, attitudes and behaviour of the Libyan people.

Islam was brought to Libya in AD 642, since when the attitudes, behaviour, beliefs and values of the Libyan people have been influenced by its teachings. Libya entered a new era of socio-cultural, political and economic development during the Islamic Empire. Arabs controlled the region until the 1500s when it was invaded and fell to European rule for about 40 years (The Economist Intelligence Unit, 1997-98), before the Ottoman Empire changed that situation (1551-1911) (Gzema, 1999). In the latter part of Ottoman rule, in the second half of the 19th century, the early beginnings of a modernisation process were seen when modern schools, hospitals, municipal facilities, a publishing house, newspapers and a number of new regulations were established, albeit being restricted to just one city, and not being available to the wider Libyan population (Attir, 1992). This situation continued in effect with the Italian invasion in 1911 because whilst they ousted the Turks, they nonetheless modernised Libya purely for the benefit of Italian settlers. Naturally, as part of this process some Libyans were able to educate their children, but there was no progression beyond elementary education allowed for Libyan nationals. Italy's defeat in the Second World War brought British and French military administration to Libya for almost a decade (Attir, 1992).

Independence was declared on 24th December 1951, by King Idris Al-Sanusi, Libya's one and only King, and from then until the end of April 1963 a federal form of government operated, after which the Unitary system was introduced and this remained in force until the overthrow of the sovereign regime on the

1st September 1969, which marked the Libyan Revolution. That brought the Libyan Arab Republic into existence, a name which was later changed on 3rd March 1977 to the Socialist People's Libyan Arab Jamahiriya (Alhossomi, 1984)

2.3 The Libyan Environment and its Accounting Practices

It is generally believed that the main objective of accounting is to produce information for decision-making, and as observed by Alhashim and Arpan (1992), this perception accounts for one of the reasons why accounting is performed differently from one country to another because people themselves are different.

Chambers (1966) stated that the foundations of accounting lie in the features of the surrounding environment, rather than in the obvious characteristics of existing rules. Hence, it is essential to consider any accounting phenomena, including corporate reporting and disclosure, within the framework of the context in which they operate (Arpan and Radebaugh, 1985; Belkaoui, 1985; Alhashim and Arpan, 1992). The environment is therefore extremely pertinent in helping to identify what is appropriate accounting practice. The idea that each country has its own financial reporting practices that emerge as a result of country-specific factors of an economic, social, political, and regulatory nature, is confirmed by Hagigi and Williams (1993). From this understanding it is natural to expect variations in practice around the globe. Indeed, as observed by Briston (1990:215), "each country is different and has different needs. The purpose of accounting is to serve society. As a

consequence, accounting is likely to be influenced by the different political, economic, social and religious environments in which it operates". In respect of such variation, Mueller (1968) suggested four contributory elements as follows:

1. State of economic development: national economies differ in their stage of development and in terms of nature, as can be seen by the range of advancement among the developed and developing countries.
2. State of business complexity: national economies differ in their technological and industrial know-how which create variance in their business needs as well as their business output.
3. Shade of political persuasion: national economies vary in their political systems, from the centrally-controlled economy to the market-oriented economy.
4. Reliance on some particular system of law: national economies have different supporting legal systems, for example they may rely on either a common-law or code-law system, and/or they may have protective legislation and unfair trade and antitrust laws.

As Belkaoui (2000, 1991 and 1989) observes, the environmental conditions likely to influence the determination of the accounting profession include:

- a. Cultural relativism, whereby accounting concepts in any given country are as unique as any other cultural traits.
- b. Linguistic relativism, whereby accounting as a language with its lexical and grammatical characteristics is seen to affect the linguistic and non-linguistic behaviour of users.
- c. Political and civil relativism, whereby accounting concepts in any given country rest on the political and civil context of that country.

- d. Economic and demographic relativism, whereby accounting concepts in any given country rest on the economic and demographic context of that country.
- e. Legal and tax relativism, whereby accounting concepts in any given country rest on the legal and tax base of that country.

Clearly, it is important for any discussion of accounting principles and practice in Libya to be grounded in an understanding of the potential effect of these environmental factors within the context of developing nations, and in this respect, it should be understood that as nations are at different stages of development, it is unlikely that a blueprint in this respect will be achievable. Moreover, the extent of the influence of any one factor or cluster of factors (economic, cultural, political, and/or legal) cannot be predicted because of the specific features of each country. Furthermore, researchers (Cooke and Wallace, 1990; Belkaoui, 1983) have argued that environmental variables do not operate in a vacuum and consequently there is every chance that they might be found to inter-relate.

2.4 Political and Economic Influences

The behaviour of organisations, and the people within them is affected in many ways by a country's political and economic systems, and accounting is variously influenced by such factors. Furthermore, in countries where governments stipulate accounting rules, and where major changes in government often occur, so too might the accounting procedures in force (Alhashim and Arpan, 1992).

This precise scenario occurred after the Al Fateh Revolution, when Colonel Muammer Gaddafi introduced dramatic changes, the most fundamental being the Declaration of the Popular Revolution in 1973, and the later Declaration of the system of Direct Democracy in 1977.

The Popular Revolution was announced by Colonel Gaddafi on 15th April 1973, and resulted in a five-point programme (translated by the Libyan Secretariat of Information, 1979) as follows:

1. The repeal of all administrative laws currently in force and deciding each case on its (own) merits.
2. Purging the country of the politically sick.
3. Freedom, all freedom, is for the toiling masses of the people.
4. Declaration of an administrative revolution.
5. Declaration of a cultural revolution

As observed by Hudson (1977), the Popular Revolution aimed to introduce an element of grass-roots spontaneity, voluntarism, and direct democracy on the one hand, and on the other hand, to replace the existing Arab Socialist Union which had failed to generate such aims and objectives. Bearman (1986) later argued that the Popular Revolution aimed to combat bureaucratic inefficiency, the lack of public interest and participation in the sub-national governmental system, and the problems of national political co-ordination. The vehicle for achieving such objectives was the system of 'Peoples' Committees' which were functionally and geographically-based, and which became responsible for local and regional administration. These Committees, in the scope of their administrative and regulatory tasks and the method of their members'

selection, exemplified the concept of direct democracy that Gaddafi proposed in the first volume of The Green Book 3, which was published in 1976.

On 2nd March 1977, a completely new system of government, known as the principle of the 'Authority of the People', was introduced by Gaddafi himself. He had campaigned for this so convincingly that he secured its acceptance in an extraordinary session of the General People's Congress GPC under his chairmanship.

The Declaration of the People's Authority was made by the GPC and contained, as stated by the Secretariat of Information (1979), the following four points:

1. The official name of Libya will henceforth be the Socialist People's Libyan Arab Jamahiriya (SPLAJ).
2. The Holy Koran is the law of society in the SPLAJ.
3. Direct popular authority constitutes the basis of the political system in the SPLAJ. Authority is for the people and no one else.
4. The people exercise their power through the People's Congresses, People's Committees, Syndicates, Unions, Professional Associations and the GPC. Their functions are to be defined by law.
5. Defence of the homeland is the responsibility of every citizen, male and female, and by general military training the people will be trained and armed. The method of preparing the military institutions and general military training will be regulated by law.

Coming through the Declaration of the People's Authority was confirmation of Libya's traditions and customs that stressed the collective rights and obligations of families and tribes. Given the position of the Declaration within

the workplace, it can thus be seen that tribal and family collectivity is institutionalised in peoples' work-related practices and social relationships (Wright, 1981).

The first wave of government reforms were implemented in 1987 and 1988 when self-management or collective ownership businesses were allowed. Simultaneously, certain public enterprises were privatised, and restrictions on private wholesale trade were removed. Subsequent reform in September 1992 included privatisation legislation which effectively progressed the move to offer a number of public-sector enterprises for privatisation, thereby identifying those economic sectors in which the private sector and individuals could invest. Production, distribution and service activities in industry, agriculture, transport, commerce, finance, tourism and the private practice of professionals, were all included, as was the establishment of privately-funded businesses, along with family and individual activities.

Unfortunately, Libya's developmental efforts met an obstacle in 1993, when UN sanctions were imposed on the country as a lever to persuade the Libyan government to hand over two suspects connected with the Lockerbie airline bombings in 1988 in Scotland. These sanctions involved a ban on military sales, air communications, and the purchase of some equipment required for the advancement of the oil and gas industry. The GPC responded by introducing a series of liberalisation measures aimed at reducing public expenditure and removing any funding that contributed to such expenditure. It also promoted private investor initiatives in different sectors (Vandewalle, 1998). In 1997, the State issued Act Number 5, which concerned Foreign

Capital Investment Encouragement. The Act encouraged foreign investments in areas that would result in a transfer of modern technology, a multiplicity of income resources, and which would contribute to the development of the national products, so as to help Libya enter into the international markets.

In 1999, the two suspects were handed over and in consequence, the UN sanctions were suspended, but not lifted. This suspension enabled some progress to be made in Libyan development, which had been severely restricted during the period of sanctions, and which had caused a situation where much reliance was placed on the attempted modernisation of the oil and gas sector.

The sanctions were finally lifted after the Libyan Government reached a settlement with the families of the Lockerbie victims in 2003. On the 19th December 2003, Libya, Britain and the United States reached an agreement whereby Libya would abandon its weapons of mass destruction (WMD) in return for improved relations. The United States then rescinded its ban on travel to Libya and authorised US oil companies with pre-sanction holdings in Libya, to negotiate for their return to the country once economic sanctions were completely removed (Otman, 2005).

A gradual improvement in relations between Libya and the US followed, and in April 2004, when the US economic sanctions against Libya were ended, a written statement from the White House Press Secretary was issued to the effect that US companies were to be allowed to buy or invest in Libyan oil and products, and that US commercial banks and other financial service providers could participate in and support these transactions (Otman, 2005).

Since that time, and with more cordial relationships with European countries and the USA, Libya has become re-instated on the world stage, and a number of international companies have invested in the country. In an attempt to give a greater role to the private sector in economic activity, the government has persisted with its privatisation policy to allow the privatisation of some manufacturing and service companies (Central Bank of Libya, 2007).

2.5 Libya as a Developing Country

There is a rich literature on the issue of what constitutes a developing or developed country, and this includes debate on the actual words to be used to describe the status of countries when making comparisons of their social and economic advancement. Higgins (1968) writing almost half a century ago, noted that the United Nations does not use the term 'under-developed' in preference to the adjectives 'developing' or 'less developing', yet he took the position that the term 'under-developed' should indeed be used to describe a country where more half the population lives in poverty. He also observed that in political terms, a country is classified as under-developed if it declares itself as so by applying for foreign aid, and if other countries provide this. He further added that an under-developed country would typically have more than one-third of its labour force engaged in agriculture, and be characterised by both technological and regional dualism.

However, two decades later, Gilbert (1986:7) argued that "the distinction between developed and less developed, rich and poor, powerful and subordinate is only a preliminary one" and that a more complex typology is required in this respect. Morrish (1988) argued that in less developed countries,

people left the countryside to find work in urban areas, and that industries faced difficulties because of lack of experience, and outdated transport systems. These initial classifications of countries by their economic achievement is nevertheless both controversial and imprecise, since there is always the potential for ethnocentric or normative considerations to influence both the formulation of the original taxonomy and the categorisation of countries on the basis of it. Poor countries, relative to more developed ones, have been variously labelled the Third World, the South, the less developed, developing, and the other world.

Furthermore, it has been demonstrated that some of the characteristics of less developed countries can actually be seen exist in developed countries, Beddis (1995) noting that whilst the USA is without doubt, one of the richest and most powerful countries in the world, it has nonetheless, much poverty and unemployment, and some nutrition experts estimate that 40 million Americans are hungry or inadequately fed. Beddis (1995) also reports that a survey of eight cities revealed that the demand for emergency food and shelter rose between 100-500% during the Reagan Administration. Likewise, Bakhshi (1991) reported that in some countries, such as India, there are areas that are as well developed as the so-called developed countries, while other parts were less developed than the least developing countries. Hence, it can be seen that within the literature, there is no perfect definition of a developing country, nor are there precise standards that can be imposed to categorise a country as such.

Actually, in 1986, the Overseas Development Council classified developing countries as those with a per capita annual income of less than US\$2,000, and

Libya, along with the USA, UK, Australia and some other countries recorded a figure of more than US\$5,000 in this respect (Gilbert, 1986). Indeed, Beddis (1995:29) has observed that “in Libya, there have been striking improvements in housing, education and health care, and special attention has been given to the rights of women in all these developments”. He goes on to say that the majority of Libyans have far higher living standards now than before the discovery of oil and the rise of the Revolutionary Committee. Consequently, there are some aspects in which Libya can be considered as developing, and yet others in which it can be said that Libya is advanced.

2.6 Social and Cultural Influences

Libya’s social structure is characterised by the extended family, the clan, the tribe and the village, all of which are major influences in the everyday life of individuals and communities alike. The family in Libyan society is by no means nuclear, including father and mother and their unmarried and married sons and daughters with their families as well as many more distant relatives and kinsmen such as grandfathers, aunts, cousins, nieces and nephews (El-Fathaly and Palmer, 1980). As highlighted by Agnaia (1996), this close relationship with one’s family imposes a regulatory framework in respect of members’ behaviour, because an individual’s actions can both enhance the respect for a family and tribe, or damage its reputation. Not surprisingly, therefore, the behaviour of family members is controlled by the greater family, and individuals are expected to obey and respect the rules and traditions of the family, clan, tribe and village.

As already noted, the Islamic religion and Arabic language which originated during the period of Arabian influence, are the two dominant elements in Libyan culture, and in this respect, Farley (1971) documents that these elements of Libyan culture laid the foundation for the social homogeneity of the Libyan people. Indeed, as Zarrugh (1959:11) documented,

“it can be confidently asserted that the years of Arabic, Turkish, and Italian rule and the final short period of British-French rule all left their mark on the religion, social and political life of the people. But of all these conquests and occupations, none had a more profound and lasting effect than Arab conquest for throughout all these centuries the country has remained Arab in culture and Islamic in religion.”

So, it can be seen that family, religion and language significantly affect the attitude and behaviour of people in Libyan and Arab society (Aghila, 2000).

2.7 The Libyan Oil Sector

Libya is the second largest oil producer in Africa, attracting revenues from oil and gas exploitation that make up between 75-90% of Libyan income, and standing as one of the biggest North African suppliers to Europe (Central Bank of Libya, 2006). It was in 1955 when the first oilfields were discovered in Libya by the Esso Company, which subsequently became the Sirte Oil Company. Six years after this discovery, in 1961, exports began from the Sirte Basin (Otman, 2005), and from that time the Libyan oil industry has been an important and attractive area for foreign investment. Whilst the sanctions imposed between 1992 and 1999 marked a halt in foreign involvement in the Libyan oil industry, that trend has now reversed and the oil and gas industry is once again thriving, the plan within the oil sector being to increase production

to three million barrels per day by 2010. Indeed, since mid-2004, much foreign investment has been made in Libya's oil and gas industry and now the entire sector is buoyant (Otman, 2005), with almost all companies being actively engaged in exploration activities. For example in 2004, the NOC announced its acceptance of bids under the framework of Exploration and Production Sharing Agreements (EPSA), and in January 2005 it officiated a bid-opening session at which 11 blocs went to US companies, whilst others went to companies from India, Canada and Australia (NOC, 2006).

Clearly, the oil sector is a major contributor to Libya's national development not only in terms of revenue and technology transfer, but from the viewpoint of creating employment and expanding human capability, since the NOC requires all foreign investors in the sector, who undoubtedly require large numbers of employees, to "employ Libyan nationals and accept responsibility for training 20% of these nationals annually, either locally or overseas" (NOC 2006).

2.7.1 The Libyan Oil Economy

As a renter state, and a key producer of high quality and low sulphur oil and gas, and because of its strategic position in respect of the Mediterranean and European markets, Libya's economy is almost totally underpinned by oil (Table 2.1). Indeed, it is the world's eleventh largest oil producer, and a member of the Organization for Petroleum Exporting Countries (OPEC) (World Markets Research Centre, 2002), with known oil reserves amounting to at least 30bn barrels, and possibly rising to 50bn, given the potential for future exploration and discovery. One key reason for Libya's low costs of oil production is that the reserves lie close to the surface. The dominance of the

industry is shown in the period 2000-2005, when the percentage of oil exports to total exports reached above 97%.

According to the World Markets Research Centre (2002), Liquefied Natural Gas will increasingly become a key source of foreign exchange revenue, and the country is eager to exploit its potential. Exports to Italy and other central European markets started in 2003, as also did a joint Libyan/Italian venture to develop both onshore and offshore reserves.

Table 2.1: Libyan Exports in the Period 1996-2005

This joint venture includes the finalisation of the Western Libya Gas Project, the subsequent construction of a gas processing site, and the proposed construction of a 1,200km pipeline from the coast in the north of Libya to Sicily. As a means to improve production, the government also wants to upgrade its main plant, in the hopes of raising production capability to one billion cubic metres a year, from the present 4.5m.

2.8 The State of the Accounting and Auditing Profession in Libya

As fully acknowledged and noted earlier in this thesis, a comprehensive analysis of the accounting profession in a particular country can only be made if that country's cultural characteristics are considered and appreciated as having influence upon how the profession develops and is maintained. In cultural terms, Libya complies with the Arab country classification identified by Hofstede (1984), and hence within Libyan society, there are high levels of power distance and uncertainty avoidance demonstrated. This carries through into the accounting profession, which essentially is not well developed (El-Sharif, 1980; Bengharbia, 1989; Selway, 2000). However, it is accepted that it has been influenced the most by the UK and the US accounting systems (Kilani, 1988), which themselves have emerged individualistic societies with low levels of uncertainty avoidance. This is in contrast to the prevailing circumstances in Libya, which is collectivist in nature, and as mentioned already, where levels of uncertainty avoidance are expected to be high. Given these cultural considerations, it might be anticipated that the accounting systems in operation in Libyan businesses may fall short of providing the appropriate kind and quality of financial information required by government and investors.

The origins of the accounting profession in Libya are not certain, but evidence does exist to show that in the last half century (since the 1950s), there have been several influential factors in the development of the profession. In particular, the education system, the teaching of accounting academics, the preferences of international companies, the expertise of international

accounting firms and to some extent, the rapid changes in the Libyan social, economic, political and legal environment, have all played their part in shaping how accountants operate. And, not surprisingly, with the presence of international oil companies in the country, the accounting profession from its early days of development, has adopted standards and methods of operation similar to those in the UK and US (Kilani, 1988).

With the establishment of the Faculty of Economics and Commerce at Garuonis University in Libya in 1957, it became possible to study accounting, and indeed, it became a popular subject. The principal influences upon the curriculum came from professional bodies and universities in both the UK and the US (Bakar and Russell 2003), the latter being influential because large numbers of Libyans studied in American universities during the 1970s (Kilani, 1988). Furthermore, the position of the US in international economics was powerful, meaning it was recognised as a leader in both accounting practice and education, and thereby worthy of copying.

However, despite these early efforts in Libyan accounting education, the regulatory body in Libya - the Libyan Accountants and Auditors Association (LAAA) - is relatively young, being in existence for only 35 years, having been established by Law No. 116 in 1973. The responsibilities of the LAAA are essentially to oversee and supervise the accounting profession, whilst at the same time ensuring its development and the continuing professional development of its members through the provision of national and international conferences and seminars (Saleh, 2001). Since the establishment of the LAAA, more formality has been introduced the profession, but in reality, very little has

been achieved by the body in terms of building a theoretical base for accounting as a profession, and a much-needed Code of Ethics that would improve professional practice, is sadly missing (Bakar and Russell 2003).

Consequently, it can be argued that the LAAA has not succeeded in fulfilling its obligations as a regulatory body and is not operating in the public interest. Moreover, there have been few efforts by the LAAA to promote continuing education and training amongst accounts as a means of improving the status of the profession (Shareia, 1994). Hence, the Libyan accounting profession has poor status.

Basically, the LAAA ignores its obligations by failing to specify uniform audit report requirements and by not requiring its members to pass professional examinations, using only university accounting education as the criterion for membership (Kilani, 1988). Furthermore, although the accounting profession is defined as in the UK and US (Kilani, 1988), environmental differences mean that the profession does not actually operate in the same way, confining itself to external financial reporting and external auditing (Bait El-Mal et al, 1973; El-Sharif, 1981; Kilani, 1988).

2.8.1 Libyan Accounting Education and Academic Research

It was 1954 when accounting education began in Libya, with the establishment of the School of Public Administration that had responsibility for training government employees in the field of accounting (SPLAJ Secretariat of Work and Civil Services). In 1957, in co-ordination with the UN, the School of Public Administration became the Institute of Public Administration. Almost a

decade later, in 1968, the Institute was upgraded to include nine different academic departments, including the Department of Accounting, and was named the National Institute of Public Administration. University level accounting education also started in 1957 with the founding of the Faculty of Economics and Commerce. After the 1969 Revolution, much more attention was paid to Higher Education, and consequently, several accounting Faculties were established in different cities in Libya during the 1980s and 1990s.

It is observed (Kilani, 1988) that between the years 1957-76, the English accounting curriculum was adopted in the Libyan universities, using accounting textbooks that were either British and written in English, this being the majority, or produced in Arabic, having been translated from English or written by Arabian writers who had graduated from British Universities. Mahmud (1997:267) confirms this historical development, noting that “the analysis of the accounting education system in Libya shows that the old system (1957-1976) was British-orientated in all its elements (curriculum textbooks and faculty members), whereas the new one (1979 present) is American orientated”. This was explained by Kilani (1988:175) as resulting from the fact that “since 1977 with the return of Libyan nationals from the US, the American accounting system was adopted in Libyan universities instead of the British education system in the Libyan universities”.

Mahmud (1997) concluded that the UK’s influence was strong in the old Libyan accounting education system. The accounting programme for the Bachelor’s degree in the old (British) system required four years, whereas the new (American) system is based on sixteen week semesters instead of a full

nine month academic year. Until the early 1970s, most of the accounting teachers were Egyptian nationals who had graduated from British Universities while a few were British, American and Canadian (The Libyan University, 1973). The shift from British-oriented textbooks to American-oriented materials came about, according to Kilani (1988), from the fact that most university teachers undertook their education in American Universities.

Of course, there needs to be a strong relationship between accounting education, the practices observed in the profession, and research activity, and it is clear that each of these three components influences, and is influenced by, the other two. They are, indeed, complementary, for instance, in terms of accounting practices and education, it can be argued that accounting education is considered as the starting point for developing an accounting profession. Additionally, education provides the profession with fresh blood that sustains the profession. The profession in turn, provides the practical experience that is then used in the content of lectures to classes, as well as the financial support for accounting programmes at many colleges and universities. With regard to the link between the profession and research, the profession usually provides the data and funds required for research projects, and then reap the benefits in terms of being made aware of best practice. Finally, the relationship between accounting education and research is evident, since as noted by Bait-El-Mal (1990), research underpins education which becomes stale without it. Research enriches education, while education equips an accountant with professional competence. In fact, however, there has been little activity amongst staff members of accounting departments in Libyan universities, and what research has been undertaken has been on a small scale only.

Research on a small scale has been conducted via projects forming part of the requirements for either MSc or PhD degrees. In this regard, after the 1969 Revolution, the Libyan government devoted more attention to Higher Education and offered many scholarships for Libyan graduates to pursue their education abroad, either in the USA or the UK, as was the then government policy in respect of accounting students. This policy was interrupted, however, since political issues had negative effects upon the relationship between Libya and the USA and UK. The relationship with the USA began to sour in 1979 when the American Embassy in Tripoli was mobbed, and three years later in 1982 the American government banned oil imports from Libya and all exports from the USA to Libya were stopped. The relationship with the UK began to go wrong with the killing of a British policewoman during a demonstration outside the Libyan Peoples' Bureau in London in April 1984. This event led to the break in diplomatic relations between the two countries. The relationship with the USA worsened in 1986 when the previous sanctions were strengthened because of alleged continued terrorist activities. In that year, the Reagan administration froze all Libyan assets in the USA, and American warplanes bombed Tripoli and Benghazi suspecting that there had been Libyan involvement in the bombing of a Berlin nightclub. The most negative effect on the Libyan relationship with the USA and the UK was the Lockerbie disaster, in which a 747 aircraft exploded over Scotland, and two Libyans were suspected of planting a bomb on board. As a result, the American and British representatives to the UN Security Council succeeded in convincing the Council to impose sanctions on Libya from 1992 until 1999. One outcome of all these political events was a sharp decrease in the number of students who

were sent to the USA and the UK, especially in the 1980s and 1990s. Consequently, there exists an extreme skills gap and shortage of academic accountants within Libyan universities and institutes, and this negatively affects the quantity and quality of accounting and auditing research.

During the period between 1992 and 1999, foreign involvement in all Libyan industry was severely reduced as a result of the sanctions and embargoes imposed, although after sanctions were removed Libya returned to the international community. Since mid-2004 foreign investment has been forthcoming and the entire sector seems poised for new development (Otman, 2005).

Since that time, and with more cordial relationships with European countries and the USA, Libya has become re-instated on the world stage, and a number of international companies have invested in the country. In an attempt to give a greater role to the private sector in economic activity, the following years have witnessed a continuation of the privatisation policy of some manufacturing and service companies (Central Bank of Libya, 2007).

As part of this return to normal political relations, the Libyan government once more paid attention to Higher Education and offered many scholarships for Libyan graduates to pursue their education abroad, for example the General People's Committee of Higher Education offered scholarships for 11,000 students during the period between 2006 and 2008, and other sectors, such as banking, offer their employees similar opportunities (GPC of Higher Education, 2009). The government policy is to focus on the USA and the UK as providers of accounting education. Additionally, the oil sector is an

important sponsor of such education, since it is a major contributor to Libya's national development. This is seen not only in terms of revenue and technology transfer, but from the viewpoint of creating employment and expanding human capability, since the NOC requires all foreign investors in the sector, who undoubtedly require large numbers of employees, to "employ Libyan nationals and accept responsibility for training 20% of these nationals annually, either locally or overseas" (NOC 2006).

It is the function of the National Oil Corporation (NOC) Training Department to source and administer training courses and conferences for the Libyan Oil Sector, and in this respect it looks to the UK, Europe, Middle East, and North America as providers. Through its own resources, it provides training, and organises courses for its clients. It also arranges conferences, technical craft courses, and supports university courses at postgraduate level (NOC, 2009). Over 400 training courses are arranged annually, catering for the needs of over 1,000 trainees per month. As an example of such activity, the figures for 2002 are offered, which show that nearly 2,500 staff attended training courses in the UK and throughout the world.

Undoubtedly, the investment in accounting education and training, made initially to satisfy the needs of the oil companies, has had a spin-off effect within the country generally, as the British and American accounting practices have been transferred from the oil and gas sector to other sectors with the movement of employees in and out of the sector (Saleh, 2001).

2.8.2 Accounting Professional Body in Libya

It was not until 1973 that auditing regulations were introduced in Libya. Prior to that time, there was no requirement for business enterprises to have their financial statements scrutinised and certified by an independent auditor. Instead, it was only necessary for such documents to be agreed by the legal representative of the taxpayer (the business) and this person could simply be a chartered accountant (Law No. 64 of 1973). On 20th December 1973, however, the Libyan government finally enacted Law No. 116 of 1973, which established the LAAA as a body which would develop the auditing profession in Libya. The LAAA was given the following objectives:

- 1) To organise and improve the condition of the auditing profession and raise the standards of accountants and auditors professionally, academic, culturally and socially.
- 2) To organise conferences, seminars and to participate in such conferences and seminars internally and externally and to keep in touch with new events, scientific periodicals, lectures, and so on.
- 3) To establish assistance and pension funds for its members.
- 4) To increase cooperation between its members and to protect their rights and
- 5) To take action against members who violate the traditions and ethics of the profession.

2.8.2.1 Registration as a Chartered Accountant in Libya

It is not permitted for any accountant in Libya to perform any kind of auditing activity without being registered as a chartered accountant with the LAAA (Law No.116, article 32). This regulation is intended to guarantee that all audits are performed by people who have the appropriate qualifications, and

who are at the same time, properly supervised. LAAA registration in itself can only be obtained if the following conditions are met.

1. **Citizenship:** applicants for membership of the LAAA must be Libyan citizens.
2. **Residence:** applicants should reside in Libya.
3. **Educational experience:** applicants should have an accounting degree from the Faculty of Economics and Commerce of a Libyan university, or any other recognised university or higher institute. For applicants to be registered in 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 practising 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.

The Executive Memorandum of Law No.116 of 1973 explains Article 24 of the law which relates to the required qualifications and experience for registration with the LAAA, as a chartered account which are:

- 1) Doctoral degree in accounting, auditing, taxation or costing from any recognised Arab 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 university or institute 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:
 - Manager or head of an accounting or auditing department in the Treasury Ministry.
 - Accountant or auditor working for the Accounting Council.
 - Accountant or auditor working for the Taxation Authority.
 - Manager or head of an Accounting department in a public bank or enterprise.
 - Teacher of accounting or auditing in any public university or institute.
 - Any other jobs equivalent to the jobs mentioned above approved by the LAAA.
- 6) Three years' experience of work in a capacity mentioned above, in addition to the following:
 - Membership of the Chartered Institute of Management Accountants in England or any equivalent certificate.
 - Membership of the Association of Chartered Certified Accountants in England or any equivalent certificate.
 - Membership of the Taxation Association in England or any equivalent certificate.

2.8.3 The Libyan commercial code

The Libyan Commercial Code (LCC) was issued in 1953 and has been amended a number of times. It covers rules on corporation books and records

keeping and financial reporting. The LCC version 1972, Article No. 58, requires that each enterprise must have at least the following books: a journal, an inventory book and balance sheet book.

However, before being used, the books must be notarised by the Court of First Instance. According to the statement made by the government in 1972, Article No. 570 corporations (joint stock companies) are required to keep the following records:

- 1) a register of members;
- 2) a register of bondholders;
- 3) a minute book of members' meetings;
- 4) a minute book of director's meeting;
- 5) a minute book of statutory auditor's meetings;
- 6) a minute book of executive committee's meetings and
- 7) a minute book of bondholders' meetings.

Further, the provisions of LCC state every corporation's board of directors is responsible for preparing a balance sheet and a profit and losses account once a year. Article 573 of LCC details the items of assets and liabilities that must be reported in any corporation's balance sheet. The financial statements are to be reported to the general assembly of shareholders for approval (Libyan Government, 1972 Article 572). A copy of an approved balance sheet and profit and losses account must be submitted to the Commercial Register (CR) within thirty days of its approval. This is to be accompanied by the director's report and auditing board report (Libyan Government, 1972, Article 583).

2.8.4 Tax Law

The first tax law used in the country was the Italian tax law in 1923. After independence the new government asked for technical help from the UN to reform its economy, and continuation of the 1923 Italian tax law was one of the UN's recommendations (Bait-El-Mal, 1981). In 1968, the government had used the Italian tax law, which was used before independence with modification to suit the Libyan environments. This law became the first unified tax law to be implemented in Libya (El-Sharif, 1981). Before the last version of the present tax law in early 2005, there was a second attempt to establish a tax law to suit the Libya in 1973. According to Bit-El-Mal (1981: 51), the new tax law No. 64 1973 shows no significant differences from the previous one.

2.9 Summary

This chapter has examined in detail, the practice of auditing in Libya. In doing so, it has initially considered the Libyan context in the full knowledge that the auditing profession has necessarily been influenced in its development and current operation by the national environment. The fact that Libya is a large country with a relatively small population concentrated in the coastal strip area has been highlighted, as also has Libya's strategic position in respect of Africa and Europe, which essentially places it well for trade, although in historic times, this also acted as a magnet for colonisers who all left their mark on the country. It has been particularly noted that during the Italian occupation, the beginnings of an accounting system emerged, and with the development of the oil and gas industry, the accounting profession in particular, has been influenced by the UK and the USA, whose standards and procedures have been imported.

It has also been shown how the Al Fateh Revolution brought about a series of reforms over several years, such that now privatisation legislation has progressed substantially, and much foreign capital is now vested in businesses in Libya, although it remains that the oil sector is fundamental in underpinning the country's economy. Given the importance of preserving efficient operations within the oil sector, the performance of accounting and auditing professionals has been shown to be of special interest to Libya, and the chapter has given this matter detailed consideration. In this respect, the history of accounting development, education and academic research, has been discussed, and it is noted how, since the normalisation of Libya's relationships with the rest of the world, once again graduates are being sent abroad for postgraduate education and training in the accounting/auditing field. The LAAA, established in 1973 as the regulatory body, has been considered in detail, and it has been noted that its remit is in keeping with that of similar organisations elsewhere in the world. In particular, the requirements for registration with the LAAA are shown to be demanding, and this stands as a signal that the aim is to produce a reputable profession.

Unfortunately, however, the political rifts between Libya and the UK and USA during the 1980s and 1990s did stem the flow of graduates from these countries, and hence the flow of new academic accountants and this has had a negative influence on the auditing and accounting research in Libya, which it is important to remedy. The next chapter provides an in-depth review of the literature in the field of auditing.

CHAPTER THREE

LITERATURE REVIEW

3.1 Introduction

This chapter aims to provide a brief review of the extensive literature that has been developed on audit quality in terms of some selected variables, and is organised as follows: the first four sections focus on auditing, providing a definition, a consideration of its importance, the demand for auditing services, and auditing objectives. Section five introduces the concept of audit quality, and in sub-sections addresses its definition, issues relating to auditor independence, and the attributes of professional auditors. The chapter progresses to address the factors that impair and enhance audit quality (section 3.7), and specifically, the size of the audit firm, the provision of non-audit services (NAS), the length of audit tenure, the level of competition in the audit market, and fees for audit services are considered. These variables are all considered as surrogates, which are used to examine audit quality in various countries. Finally, the chapter concludes with a summary.

3.2 Definition of Auditing

As a profession, accounting is concerned with gathering information regarding financial matters, and summarising and communicating this information. It is particularly associated with business organisations and a wide range of players are involved make use of the information provided, such as creditors, banks, government agencies, shareholders, investors, and financial analysts.

Within the discipline of accounting, auditing stands as a particular function, which according to the American Accounting Association Committee (AAAC) (cited in Dunn, 1996) is a means of systematically and “objectively obtaining and evaluating evidence regarding assertions about economic actions and events to ascertain the degree of correspondence between those assertions and established criteria and communicating the results to interested users”. Arens et al (1997:20) describe accounting as a procedure whereby “a competent, independent person accumulates evidence about quantifiable information related to a specific economic entity for the purpose of determining and reporting on the degree of correspondence between the quantifiable information and established criteria”.

Clearly, and as expected, these definitions have some common ingredients, the first of which relates to the need for objectivity and independence. A second common theme is the gathering of relevant information, and from these first two features, it follows that for the auditor to perform his/her job effectively, s/he must be properly qualified and competent to source the appropriate information, and conduct a comprehensive investigation in a totally objective and independent fashion, before reaching conclusions on what the information conveys.

A third feature that is implied in both definitions is the fact that auditing is regarded as a systematic process, thereby highlighting a set of rules to be followed. A final commonality is the business of communicating the outcome of the process such that the users of the audited information reported can

establish the amount of agreement between an organisation's financial goals and their actual achievement.

3.3 The Importance of Auditing

As already indicated, auditing is part of the wider discipline of accounting, and its specific purpose is to verify that an organisation's financial and economic information present an objective indication of the organisation's financial situation. Implicit in this is the idea that any developments, whether positive or negative, will be revealed in the audit. In many countries it is a legal requirement for all public companies to instruct independent auditors to examine their financial affairs, since "the audit function is intended to prevent doubt arising about the quality of the financial accounting information that the law requires the company to present to its shareholders" (Lee and Kenley, 1985:10). Audited financial statements also represent a way to confirm or correct information received earlier by the market. Effectively, audited statements play a part in assuring market efficiency, since they curtail the existence of information which is wrong and hence, may damage the market. The importance of the audit process, is therefore, seen in respect of the users of audited financial information, who can range from principal shareholders right down to members of the public, who can easily be affected by a financial crisis in a company that might appear at first sight to be quite unrelated to them. Such users turn to independently-audited documentation in the expectation that the financial information is both (1) unbiased and contains no management spin, and (2) neutral with respect to the various groups it involves. Such published

financial information is also important as the basis on which judgements are made for investment, and lending decisions (Gill et al, 1999).

The need for independent audit within the general business environment can be seen to arise from four circumstances, which are identified by (AAA, 1973) as being:

1. **Conflict of interest (potential or real):** This may occur between the provider of information, and the eventual user, and may be reflected in bias in the information given for general consumption.
2. **Consequence:** Often financial information is used as a basis for decisions that will have significant consequences, and as seen above, without independence in the auditing process, information may be offered that is biased, misleading, irrelevant or incomplete.
3. **Complexity:** With the growth of a more sophisticated business environment, the information to be communicated has become more complex, and users have found it more difficult or even impossible, to obtain direct assurance about the quality of the information with they are presented.
4. **Remoteness:** Sometimes, the recipient of financial information is not close to the source of that information, and is unable to personally and directly check its quality (Hermanson et al, 1993).

3.4 The Demand for Auditing Services

Depending on the reasons why an audit is performed and hence, the focus of the audit, the type of auditing services differs, and in this respect there are many varieties of service that can be performed. The demand for auditing arises from three sources according to Benston (1985), the first being from owner-managers, professional managers, and investors who wish to ensure

contract compliance. Government represents the second source, and the general public (i.e. clients, citizens and watchdogs) the third.

In the case of owner-managers, the rationale for audit is, as noted by Benston (1985), concerned with the possibility that employees may attempt to make personal gains and consequently, may misreport their activities. The potential for them to do this is believed to be reduced by an internal audit process but the possibility still remains that collusion may take place between the auditor and the audited, and therefore, an external audit performed by an independent expert is a better way of monitoring employee performance. Moreover, outside investors (shareholders) may wish to secure independent assessments from external auditors because they want to guard against any temptation for owner-managers to use company resources for their personal benefit. Clearly, owner-managers are in a prime position to do this, leaving outside investors with little opportunity to directly monitor their actions, so an independent auditing process ensures that owner-managers are doing their jobs professionally and ethically. Such a process is both beneficial to investors and owner-managers since it makes management actions transparent and this helps to safeguard the reputation of the owner-managers themselves. Sometimes also, owner-managers want to withdraw from active management and to employ instead professional managers, and clearly in these instances, owners want guarantees that professional managers and employees have no opportunity to make false reports for personal gain. In all these circumstances, the role performed by auditors in respect of guaranteeing the credibility of financial statements is crucial.

In the case of government requirements for audit, these emerge from the need to be able to assess taxation obligations, and also to be certain of an organisation's stability, especially if government is a likely investor, and greater confidence in financial reports is promoted by independent auditors. Government financial reporting requirements differ in their degree of complexity, and the more complex they are, and the higher the cost involved to an organisation by not complying with these, the greater the need to engage the services of a professional auditor.

In the case of public demand, it is customers, citizens and watchdogs, who have a stake in this respect, since the financial condition of producers is of both direct and indirect concern to the general public, even in respect of non-governmental products and services. In the banking sector, for example, there is a clear need for the general public to be informed since personal deposits are entrusted to banks, and complete assurances are required regarding banks' effective management. Hence, there is a demand for auditing services. Likewise, the general public has an interest in the management of government monopolies since the resources of such enterprises are in public ownership, and there is always the possibility that officials might misuse these without proper accountability. Again, independent auditing guarantees effective use of public resources, and at the same time, protects the reputation of officials. In respect of watchdog organisations with responsibility for monitoring other organisations, they too require audit services as part of their method for carrying out their supervision role, since without these they would be unable to report to the general public that the organisations within their remit were

operating properly. Watchdogs want legislation or government regulations that require corporate and government reports to be certified by auditing.

Pike (2003), however, also provides another reason for the demand for auditing services, this being information asymmetry, and his point is confirmed by the history of the development of auditing, which shows that with increasing separation of ownership and control, and increasing specialisation of auditors, the symmetry of information between auditors and owners diminishes and this is problematic (Pike 2003).

Figure 3.1: The Demand for Monitoring

Titman and Trueman (1986) argue that an entrepreneur who wishes to provide favourable publication information about a firm's value will employ a higher-quality auditor and investment banker than an entrepreneur who has less favourable information to disclose. Consequently, audited reports resolve information asymmetry, thereby providing a more appropriate valuation and pricing of the firm.

3.5 Objectives of External Auditing

The role of external auditors in financial statements has been documented by the British Standard, Statement of Auditing Standard SAS 100, Objectives and General Principles Governing an Audit of Financial Statements. This emphasises that an audit in this context has the primary goal of enabling auditors to provide an assurance that financial statements in their totality properly reflect an accurate picture of a given financial situation, and have been produced according to the required accounting procedures. The IFAC Handbook (IFAC, 1997:50) is clear that the purpose of external auditing is “to enable the auditor to express an opinion whether the financial statements are prepared in all material respects, in accordance with an identified financial reporting framework”, and this is confirmed in the ISA Exposure Draft (2004:56). Clearly, to form an opinion, auditors must collect enough audit evidence. The main audit objectives can be seen as:

- To make sure that financial statements do give a true and fair view of an organisation’s financial position, and inform users if, in the auditor’s opinion, there is misrepresentation or insufficient evidence for the auditor to say whether or not there is fair presentation.
- To emphasise management’s responsibility in preparing the financial statements since it is management who supply information to the auditor and who decide what to disclose, where there is choice in this matter.
- To explain the auditor’s role in reviewing financial statements, and the fact that it is his/her responsibility to discover material errors, illegal acts and other irregularities. Only by acting in this investigative way, can an auditor show his/her efforts to find any misrepresentation in the financial documentation s/he is reviewing.

3.6 Audit Quality

According to the literature, auditing has an influence on the integrity of financial information, since the greater the level of the audit, the greater it is likely that more accurate information will be presented (Colbert and Murray, 1998; Davidson and Neu, 1993; DeAngelo, 1981a; Lennox, 1999a). This idea is, however, one that is usually taken for granted because it is hard to obtain empirical measures of audit quality, and there is disagreement in the literature as to whether one should assume that audit quality can differ. Indeed, several writers (see, for example: Choi et al, 2008; Nichols and Smith, 1983; Simunic, 1980; Wyer et al, 1988), have not been able to identify any instances of variation in audit quality, whereas others have found evidence of differences (see, for example: DeAngelo, 1981a; DeFond et al, 2002; Francis, 1984; Lennox, 1999c; Reisch, 2000; Rushinek and Rushinek, 1990; Vanstraelen, 2000). Undoubtedly, the value of an auditor's report is ultimately connected with the rigour with which the audit process has been approached.

In recognition of the difficulty in measuring audit quality, scholars have chosen to use surrogates for audit quality, which have included: the size of the audit firm, the provision of NAS, auditor tenure, and audit fees (see, for example: Shawn and Dana, 2008; Fearnley et al, 2005; DeAngelo, 1981a; Al-Mogbel, 2006; Jensen et al, 2005; Palmrose, 1988; Beatty, 1989; Rushinek and Rushinek, 1990; Burgstahler et al, 2006; Ball and Shivakumar, 2005; Deis and Giroux, 1992; O'Keefe and Westort, 1992; Gonthier-Besacier et al, 2007; Jang and Lin, 1993; Mutchler et al, 1997; Geiger et al, 2006b; Colbert and Murray, 1998; Lennox, 1999b; Morris and Strawser, 1999; Krishnan and Schauer,

2000; Krishnan, 2005; Chung and Kallapur, 2003; Ashbaugh et al, 2003; Frankel et al, 2002; Gul et al, 2003; Watts and Zimmerman; 1983; Ghosh and Moon 2005; Bae et al, 2007).

In the following sub-section, these various factors that have been taken as substitutes for audit quality are briefly considered.

3.6.1 Definition of Audit Quality

A precise definition of audit quality is difficult to identify, since some scholars consider the concept in relation to the extent to which the audit conforms to the required auditing standards (Krishnan and Schauer, 2001; McConnell and Banks, 1998; Tie, 1999). However, other writers accept that audit quality has multiple dimensions, resulting in varied definitions, the classic one perhaps being provided by DeAngelo (1981a) who suggests that audit quality is the co-existing probabilities that an auditor will discover and also report any infringement in a client's system of accounting. A similar approach is taken by Lee et al (1999) who make the point that when confronted with material errors in a financial statement, an auditor will not accept this, and will instead make some qualification on that statement. According to some researchers (see for example: Beatty, 1989; Titman and Trueman, 1986), the accuracy of the information reported on by the auditors, will be reflected in the audit quality.

Palmrose (1998) agrees with this idea, defining audit quality in assurance terms, since the aim of the audit process is to give an assurance about the accuracy of financial statements. The probability that such statements are free from bias and mis-representation is embraced by the term audit quality, which

is reflected in the results of the audit process. Of course, the question remains as to how the users of audited financial statements actually assess their level of assurance and reliability. The definition of audit quality, according to Palmrose (1988), is restricted to something that can only be seen after the event.

An auditor's ability to determine whether a financial statement contains fact or fiction is derived from his/her professional expertise, which should encourage him/her to report accurately and disclose any incorrect statements. However, an auditor's behaviour in this respect (his level of independence/objectivity) may be influenced by several factors, such as economic dependence on a client (Lord, 1992), competition in the audit market (Shockley, 1981), and the policy of the audit firm to which he belongs (Johnstone et al, 2001).

According to Francis (2004), audit quality is positively associated with earnings quality, and as noted by Raghunandan (1993), auditors' reports are used by investors, together with other financial statements to help in making decisions concerning investment. Consequently, audit quality is important for the general public.

Perhaps because it is recognised that audit quality is important and of great relevance to a much wider population than might be thought initially, the idea that audit quality should be tied to standards, as indicated in the first paragraph in this section, is popular. In this respect, Sutton (1987) argues that audit quality should be defined as the degree to which auditing conforms to a set of pre-determined standards related to the characteristics determining marketplace value and the service's performance of the function for which it was designed. Hence, as Reed, Trombley and Dhaliwal (2000) comment, audit quality relates

to the degree to which the process follows the prescribed standards for auditing, the extent to which the client's expectations of the client are met, and the degree to which the social responsibilities of the profession are satisfied.

Moizer (1993) believes that a true definition should emphasise the two main conditions of a quality audit, these being that it is both technically competent and independent. Technical competence is taken to mean that the auditor has the expertise to know what evidence is required, and that s/he has the ability to interpret this accurately and is able to identify frauds and errors if present. An independent auditor must either correct, or disclose any material frauds and/or errors that s/he has detected, but an auditor who is not independent may choose not to do so. Ideally, there should be a positive relationship between expertise and independence.

The two common factors in the many definitions coming forward from writers in the field are demand and supply in respect of independent and competent auditors.

The use of these substitute definitions may allow for variations in legal systems and differences in the efficiency of capital markets that may exist between developed countries and developing countries since the legal system and capital markets in developed countries are likely to be more efficient than those in developing countries.

3.6.2 Auditor Independence and Audit Quality

According to Pike (2003), auditor independence is the foundation of the auditing profession, and as argued by Richard (2006), high levels of audit

quality rely on the proper balance between the auditor's independence, competence, professional and personal relationships.

Higson (2003) without auditor independence, the issue of whether the figures in the financial reports are correct is seriously called into question, meaning that in fact an audit carried out in such circumstances is actually a waste of time. Pike (2003) recognises that the requirement for auditor independence resolves conflict between auditors and owners, since the auditor must abide by standards set by the profession. As a result, the importance of auditor independence is a variable that should be considered in research activity.

Over recent years, however, an increasing concern has emerged in connection with auditor independence and the resulting audit quality, since it is accepted by the SEC and the AICPA, and the literature in the field, that high quality audits are required to underpin the proper operation of the capital market system. During the 1990s, various influences brought changes in the audit field. Firstly, the importance of revenue from non-audit activities to audit firms increased. Secondly, legal reforms decreased the liability of audit firms as also did the ability to organise as limited liability entities. Combined with these events, some of the largest audit firms merged. This raised developing anxieties about auditor independence and audit quality, apparent in comments from SEC regulators (Wallman, 1996; Saul, 1996; Schuetze, 1994; Levitt, 1998; Turner, 1999, 2000). It is fair to say that the profession itself tried to stem concerns about increasingly-impaired independence and the resulting decreased audit quality, but there is no doubt that difficulties surface when an auditor is not independent and is thus, less motivated to perform a quality

audit, and if misstatements are detected but go unreported, it is not easy to identify quality and independence.

According to the AICPA and SEC, independence is generally defined as a state of mind that is conducive to objective and unbiased judgements in relation to the reporting of financial matters. However, regardless of the search for total independence, academic research concerning the psychology of decision-making suggests that it is not possible for rational human beings to operate in the absence of bias (Bazerman et al, 1997). DeAngelo (1981a) believes that one should talk in terms of the probability of disclosing a material misstatement if discovered, by an auditor who may have economic incentives not to do so (DeAngelo 1981a). Theory suggests that the characteristics of both the auditor and the client, together with the existing relationship between them, are likely to be influential on auditor independence and audit quality.

There is a difficulty, however, concerning DeAngelo's (1981a) definition, that being the problem of actually recognising independence in the auditing process, since the only opportunity to observe breaches is when they are brought to the attention of the client. Hence, it is not possible to gauge the conditional probability. It is perhaps more useful to take features that are observable, for example audit quality, and personal circumstances, and infer from the level of quality whether the auditor is independent or otherwise. Good quality in the situation where the auditor has incentives to bend the rules, can be taken as a demonstration of independence, as too can a hard-earned reputation for quality. Such reputation is the product of various public messages regarding the audit firm's commitment to quality (Ippolito, 1990,

Gallouj, 1997) and of other observable factors, for example the absence of litigation, the lack of audit failure, or the compulsory provision of documentation that reports on the accuracy of previous estimates for different accounting periods. Given that there are not many opportunities to observe quality, they assume greater importance. Indeed, much research has probed this issue of how independence is perceived, and the consensus is that the concept of perception is of no value in this respect (Farmer et al, 1987; Lowe and Pany, 1994; Pearson, 1985).

Clearly, audit quality is associated with the degree of independence demonstrated by the auditor, as promoted by the variables already mentioned (firm size, tenure, fees, and NAS), but it is also a function, as noted by Richard (2006), of the appropriate balance between auditors' freedom and their personal and professional relationships with the client. In this connection, a study by Kleinman et al (1998) examined the interaction between auditors and clients on auditor independence, finding the need to achieve a professionally-acceptable balance. Their model of the relationship between auditor independence (as shown by audit firm characteristics) and audit quality is provided as Figure 3.2.

Figure 3.2: The Relationship between Audit Firm Characteristics and Auditor Independence and Audit Quality

3.6.3 Auditor Attributes and Audit Quality

The literature and standards governing audit conduct, do highlight a number of factors that can promote and strengthen audit quality, all of which can be categorised as ability and professional conduct (Catanach and Walker, 1999). Auditor attributes covering such characteristics as ability to scrutinise, technical competence, knowledge, experience, industry specialisation, technological proficiency (Catanach and Walker, 1999), and professional scepticism (IAASB, 2004b), are seen to be pre-requisites.

With respect to industry specialisation, it has been confirmed by several studies (Balsam et al, 2003; Owroso et al, 2002) that auditor knowledge of the

industry provides the auditor with the capacity to be more effective and to report lower discretionary accruals than those of non-specialist auditors, and according to other studies (Hogan and Jeter, 1999; Solomon et al, 1999) to promote high quality. It is also found (Lys and Watts, 1994) that technological proficiency is a positive attribute of auditors since this allows for the provision of more structured audit activities that improve audit quality.

ISA 240 states that auditors should demonstrate a questioning mind, a critical assessment of audit evidence, and proper planning and execution of an audit (IAASB, 2004a). It also places a duty on auditors to identify any fraudulent activities (IAASB, 2004b). Clearly, this regulation is aimed at developing professional scepticism in the interests of a rigorous audit process.

Likewise, the AICPA (1991:4-12) stipulates the need for auditors to display their independence, objectivity, integrity, due professional care, and judgement (Catanach and Walker, 1999; Porter et al, 2003), and the APB (2004) focuses on the requirement for integrity, objectivity, and independence as ethical standards to be upheld in the auditing process. The IFAC (2005) emphasises independence as the key attribute from which integrity, objectivity, and professional scepticism follow. All of these characteristics signal the absolute requirement for the absence of any personal bias whatsoever within auditors (Porter et al, 2003).

Unfortunately, the difficulty in measuring audit quality has led researchers to use different variables as surrogates for audit quality, such as size of the audit firm, auditor tenure, the provision of NAS, competition, and fees for audit services. This research attempts to elicit professionals' perception of these

factors with the aim of gaining insight into audit quality factors that may be unobservable by the public.

3.7 Factors Impairing and Enhancing Audit Quality

3.7.1 Size of the Audit Firm

The literature indicates that satisfactory levels of audit quality are usually more evident in large audit firms than in small ones, the reason being that the larger the firm, the higher the number of clients, and the greater the probability that the range of services provided is bigger. This minimises dependency on particular clients. Additionally, large firms have more resources and are able to take steps to publicise their services and develop a reputation. As a result of this, they are usually considered as providing a high quality service, and the size of the audit firm has, therefore, been used as a surrogate for audit quality (DeAngelo, 1981a). Large audit firms (the Big Four for example) can devote much investment to the provision of training courses and other resources necessary to ensure their staff are competent, able to perform the audit function to a high standard, and are less likely to be compromised by actions of clients (DeAngelo, 1981b; Dopuch, 1984; Gul, 1991; Wilson and Grimlund, 1990). A discussion of firm size, its characteristics and the various empirical studies that have identified its relationship with audit quality now follows.

Size of audit firm is identified in different proxies in the literature. Several researchers have considered this in terms of the provision of multi-services to many clients (DeAngelo, 1981a; Dopuch, 1984; Gul, 1991; Wilson and Grimlund, 1990), in terms of the proportion of fees charged for both audit and

NAS (Shockley, 1982), as the audit firm's market share revenue (Gul, 1991; Porter et al, 1996), or on the basis of internationality (Jang and Lin, 1993; Mutchler et al, 1997; Krishnan, 2003) using variations between the Big Eight, Six, now Four, and non-Big Four.

3.7.1.1 Features of Audit Firms

Other features of audit firms such as the size and number of audit clients, are also regarded as signals of quality. In this respect, it has been suggested by researchers that large audit firms produce a higher level of audit quality than small audit firms (see, for example; Colbert and Murray 1998; Davidson and Neu 1993; DeAngelo 1981a; Lennox 1999b), although the profession itself rejects this idea. In fact, large audit firms are increasingly criticised on the basis of their size, by both regulators and smaller firms within the auditing profession.

This is an issue about which the literature offers much debate because whilst on the one hand, large audit firms usually provide highly-structured training programmes and aim to differentiate their audit approaches from their competitors, thereby showing relatively higher levels of consensus (Lin et al, 2003), some researchers do, on the other hand, argue that audit firm size has no influence on quality, since there is homogeneity across different sized audit firms due to professional standards, and consequently the size of an audit firm should be irrelevant in the selection of an auditor.

Nonetheless, audit quality may be enhanced by the possession of greater resources, and potentially more powerful technological capabilities, and

consequently as some researchers point out (Beatty, 1989; Titman and Trueman, 1986), larger firms that possess such enhanced resources have more potential to produce accurate and precise information than smaller audit firms, not least because they may be able to attract top performing auditors. With these supposed capabilities, the prestigious big audit firms may be preferred by large organisations, such as bankers and underwriters, who can afford to pay their enhanced audit fees (see, for example; Nichols and Smith, 1983; Simunic, 1980; Wyer et al, 1988).

3.7.1.2 Size of Audit Firm and Audit Quality

A number of reasons exist to explain the importance of the relationship between firm size and audit quality. One of these is the fact that audit firm size is immediately observable and can therefore be readily used as an indicator of audit quality; and another justification is that if a positive relationship can indeed be demonstrated between size of audit firm and audit quality, then a rationale is provided for the demand for continuing professional education in all audit firms, irrespective of their size. Thirdly, if audit quality and size are shown to be related, the structure of liability insurance premiums could also be affected (Colbert and Murray, 1998). Nevertheless, despite these arguments for the importance of audit firm size in producing a quality outcome, it is still suggested that audit quality is independent of firm size (Arnett and Danos, 1979). However, audit firms do provide differing quality audits, increasing with the size of firms, in response to varying demands for quality amongst clients because different companies have different levels of agency costs (Arrunada, 1999). The extent of the debate on this particular issue suggests a

difficulty in reaching a policy decision on it, and it is argued (Arnett and Danos, 1979) that it is unfair to distinguish between large and small audit firms if professional standards and qualifications are maintained throughout the sector. They comment: "If we assume that the quality of the auditing is the same regardless of the size of the firm performing it, the banker would be supplied with the same information on which to base his decision; in this way the size of the firm should not necessarily be a consideration" (Arnett and Danos, 1979:6).

Arguments in the opposite direction are many, and Naser and Al-Khatib (2000) have indicated that good quality corporate reporting is associated with the status of the audit firm since those that are affiliated to large international firms are known to publish high-quality information. These large international audit firms do have a reputation it is true, and arguably in order to protect this, their audit quality and credibility, must be consistently good. This may, of course, be reflected in audit fees.

Recent research by Michael (2007) has demonstrated that clients audited by large firms generally have lower abnormal accruals, and are more likely to meet the benchmark earnings targets of small profits and small earnings increases. Additionally, Michael (2007) found that large offices are more likely to issue going-concern reports. Clearly, there is a substantial difference in audit quality depending upon the size of the audit company, larger ones producing higher quality audits. Indeed, Abu Bakar et al (2005) reported that audit firm size appears to be the most influential factor in securing audit quality and auditor independence.

This position was noted by DeAngelo (1981a), but she suggested a theoretical basis, this being that the relationship between clients and incumbent auditors is a two-sided monopoly, in which both parties wish to retain their established relationship, because neither one has a perfect substitute available. Clients need auditors with good reputations, and in turn those auditors need clients who can afford to pay them, so an end to their relationship would be damaging on both sides. Additionally, this theory predicts an inverse relationship between the size of the start-up transaction costs and auditor turnover. When auditors earn client-specific quasi-rents, audit quality is not independent of auditor firm size, as these quasi-rents serve as collateral against opportunistic behaviour, when subject to loss from the discovery of audit quality that is lower than expected. This suggests that the bigger the audit firm, as measured by the number of current clients, and the smaller the client as a proportion of the audit company's total quasi-rents, the less incentive there is for the auditor to behave opportunistically, and the greater the perceived audit quality. Hence, there is greater incentive for large audit firms to supply higher quality audits to avoid any damage to their reputation. Consequently, audit firm size serves as a proxy for audit quality.

Offering a different viewpoint on the relationship between firm size and audit quality, Dopuch and Simunic (1980) argue that a product-differentiation theory can explain many of the apparent monopolistic characteristics of the industry. They suggest that different auditing firms are perceived by investors to offer auditing services that are qualitatively different, and specifically the former Big Eight (now Big Four) are considered to be more credible than other auditing companies. Dopuch and Simunic (1980) consider audit quality to result from

the number and extent of audit procedures performed by the auditor, and this in turn relates to the resources available to audit firms, since these may allow for more powerful tests to be performed. In order to test this hypothesis, Nichols and Smith (1983), using a market model methodology on event studies, examined whether positive abnormal returns accrue to organisations that move from being audited by non-Big Eight to Big Eight auditors, and also whether negative abnormal returns accrue to firms which move in the opposite direction. They found an apparent positive, but not statistically significant, reaction from the market, and consequently did not offer strong support for the Dopuch and Simunic (1980) argument. In fact, it has not been determined whether this disagreement comes from a weakness in the model, or its application by Nichols and Smith (1983).

Reputable auditors' performance, as perceived by investment bankers and their clients, at the time of an Initial Public Offering (IPO), was investigated by Menon and Williams (1991), since this is a time when a change to the auditing arrangements may have occurred. Their study examined the nature and frequency of auditor changes prior to the IPO, and identified the characteristics of firms seeking a higher level of auditor credibility by the use of logistic regression. All companies that had filed a final prospectus with the US Securities and Exchange Commission (SEC) in 1985 and 1986 for their IPO of common stock were included, but in fact there were fewer instances than expected of auditor change in companies about to go public. However, where such changes did occur, they were in the majority of cases, of small auditors being displaced by larger, more reputable ones.

Using a sample of audit working papers of 308 Quality Control Reviews (QCR) from the period 1984-1989, Deis and Giroux (1992) examined independent school district audits and audit quality determinants provided by small and independent CPA firms in Texas. Their most important finding was that larger firms had less deficient paperwork than smaller firms. In contrast, Knapp (1991), investigating the effect of key audit variables in the assessments of audit quality of a sample of audit committee members, found no significant effect of auditor size on the discovery assessments, although there was more probability of disclosure among the Big Eight.

Jang and Lin (1993) used a similar sample to that of Menon and Williams (1991), to examine the relationship between independent auditor selection and trading activity. They considered the trading volumes of IPO stocks for 30 days after initial offering, and using regression techniques, found trading volume on the first trading day to be significantly larger for companies audited by Big Eight audit firms than for firms audited by non-Big Eight audit firms. Whilst for several subsequent days there was no clear difference, the daily volume was smaller for Big Eight audit firms' clients than for the others.

Davidson and Neu (1993) used management earnings forecasts as another surrogate to test the association between audit firm size and audit quality. The authors found that a higher level of quality is associated with larger forecast errors, since management had fewer opportunities to minimise the difference between forecasted and actual income.

Thus, if larger audit firms provide higher-quality audits, they will be associated with larger forecast errors, all else being equal. Likewise, but in a different

context, Lee et al (2001) used the Big Six and non-Big Six auditors as a surrogate for differentiation of audit quality when investigating the relationship between accuracy and bias of earnings' forecasts provided in Australian IPOs. They found Big Six auditors' forecasts to be more accurate than non-Big Six auditor's predictions, and that Big Six auditors were more conservative than their non-Big Six auditors, and produced less optimistic forecasts.

O'Keefe and Westort (1992) considered the reasons why several studies have found a positive relationship between large firm size and the probability of error detection. They identified these as being: firstly, personnel in large firms become more specialised, and secondly, CPAs in larger firms are involved in significantly more continuing professional education than CPAs in small firms. Hence, audit teams in big firms are expected to have greater technological knowledge than those in small firms, and to be more skilled in the detection and correction of errors.

Research by Krishnan and Schauer (2000) found a relationship between a firm's participation in a peer-review process, and financial disclosures, which were more likely to be made when such a review was in place. The reason (Watts and Zimmerman, 1986) is that large audit firms are often in partnership with others and each partner is liable for the firm's debt so peer-review monitoring is required to protect all parties' reputations and financial standing, and according to Beattie et al (2001), to stand as an additional guarantee of auditor independence. Some large audit firms also establish their own internal quality review. In the UK, independent units, such as the Joint Monitoring Unit

(JMU) and the ACCA monitoring unit are responsible for reviewing the audit quality of audit professionals.

Colbert and Murray (1998) contributed to the literature, which concentrates mainly on the larger audit firms, by conducting research with a nationwide sample of 422 small firms selected from the Private Companies Practice Section (PCPS), the Peer Review Programme (PRP), and the American Institute of Certified Public Accountants (AICPA), which provides comprehensive measures of audit firm quality. They found a positive association between firm size and audit quality in firms that perform audits, reviews, and compilations (but not in firms that perform reviews and compilations, but no audits). Hence, audit firm size is only a useful quality surrogate for firms that conduct audits.

Mutchler et al (1997) point out that Big Six auditors were more likely than their non-Big Six counterparts to issue going-concern opinions, suggesting that larger firms are prepared to take an aggressive in issuing an appropriate opinion, that they have better technical ability to detect the going-concern issue, or have more clients with such issues. Additionally, auditors are less likely to issue going-concern modifications to larger companies which later go bankrupt, possibly because they are more confident that larger companies can sit out their financial difficulties, or maybe because they fear that issuing the going-concern modification will itself precipitate failure. Similarly, Morris and Strawser (1999) assert that banks receiving modified audit reports from Big Six audit firms were more likely to continue, and not face closure by the regulators than those receiving modified audit reports from non-Big Six audit firms. In

contrast, banks with non-modified audit reports from non-Big Six audit firms were more likely to be closed than those receiving non-modified audit reports from Big Six audit firms. Hence, banks audited by the Big Six are more likely to be allowed to continue, consistent with regulators' perceptions that economic reporting incentives may result in Big Six audit firms being more likely to modify their opinions to reflect going-concern uncertainties. On a similar theme, Krishnan and Schauer (2000) examined the relationship between firm size and audit quality in a sample of 164 Voluntary Health and Welfare Organisations (VHWOs), using their compliance with eight Generally Accepted Accounting Principles (GAAPs) disclosure requirements as the audit quality measure. Investments, valuation of fixed assets, form of audit report, cash donations and pledges, donated materials and services, presentation of statement of functional expenses, presentation of balance sheet and other statements, were the principles. The auditors were considered as three groups: the Big Six, large non-Big Six, and small non-Big Six. It was found that the extent of compliance increased as organisations moved from small non-Big Six to large non-Big Six and from large non-Big Six to the Big Six. Furthermore, other influential factors in respect of audit quality were identified, these being client size and financial health, which had a positive relationship, and client wealth which had a negative impact on audit quality. Geiger et al (2006b) observe that when compared with non-Big Four firms, Big Four firms significantly reduce their issuance of going-concern modifications to bankruptcy clients after the Private Securities Litigation Reform Act, suggesting lower quality reporting for Big Four firms.

In a more recent study, Chung and Kallapur (2003) found that incentives offered to auditors definitely compromised their independence. This issue was related to client importance and was based on the economic theory of auditor independence. They used ratios of client fees and NAS fees divided by audit firms' US revenues as surrogates for audit practice, business revenues and measure of client importance, and examined the association with abnormal accruals in the Jones Model using a sample of 1,871 clients of Big Five audit firms. No statistical association was reported between client importance ratios and abnormal accruals in part of the sample based on size, and client opportunities, as proxies by business and geographical segment diversification. In another study in a similar context, Krishnan (2003) explored the relationship between audit quality and pricing of discretionary accruals, finding that Big Six clients, report lower amounts of discretionary accruals than non-Big Six clients, and the relationship between stock returns and discretionary accruals is greater for firms audited by Big Six auditors than for those audited by non-Big Six auditors. Furthermore, the discretionary accruals of Big Six auditors' clients have a greater association with future profitability than those of non-Big Six auditors. And finally, the stock market acknowledges the superiority of Big Six auditors over non-Big Six auditors only for discretionary accruals. Overall, the outcomes of Krishnan's (2003) study are consistent with the idea that higher audit quality is associated with Big Six auditors, and this is reflected in the security returns of the clients of Big Six auditors.

In recent research, Choi et al (2008) indicated that a fee premium is charged by large audit firms because they face higher legal liability costs, and hence, have more incentive to make a better effort than smaller firms. These researchers

suggest that the fee premium decreases as the legal regime becomes stronger because small auditors have a higher audit failure rate than Big Four auditors, and increase audit fees significantly more to compensate for their increase in legal liability costs.

Hudaib (2003) has identified audit firm characteristics which are perceived as necessary for high independence, and hence audit quality, and these appear in Figure 3.3. Large audit firms that have large numbers of clients and offer multi-services are in a better position to resist client pressure, and hence are believed to produce high audit quality and high independence. Consequently, auditor independence can be considered as the factor that covers most audit quality variables.

Figure 3.3: Power in Withstanding Pressure Based on Audit Firm and Auditee Characteristics

The literature on firm size has clearly highlighted that whilst different samples and methods have been used by different researchers, there is a positive relationship between firm size and audit quality. Specifically, large audit firms have more resources which they can direct to the recruitment and training process, thereby providing them with the human capability to detect and correct errors in financial statements. Moreover, as larger audit firms have reputations to preserve, they are careful to report deficiencies. That said, many of the differences between large and small firms should be eliminated by the maintenance of professional standards and qualifications, and a more efficient regulatory framework.

The literature does show, however, that some studies have not found a relationship between audit firm size and measures of quality. In 1988, Imhoff surveyed financial analysts, finding that they saw no difference in quality between Big Eight and other audit firms. Likewise, the American Institute of Certified Public Accountants (AICPA) argued that audit quality is independent of firm size. Additionally, Chandler (1991) found audit quality to be a feature of particular auditors, and not firms. All certified public accountants (CPAs) meet the same exacting standards for admission to the profession and participate in professional education annually (AICPA, 2002). Moreover, all AICPA members are subject to three-yearly external review of their auditing practice (AICPA, 1992). And, the collapse of Arthur Andersen and the opposition to peer review in large audit firms, as found by Fearnley et al (2005), would seem to indicate that individuals are responsible for providing audit quality rather than audit firms.

In addition, the Sarbanes-Oxley Act (2002) introduced the Public Company Accounting Oversight Board (PCAOB) as a monitor for auditor professionalism, and as a replacement for the peer review system because of anxieties concerning the potential for compromising quality control among peers. Krishnan (2005) has consistently argued that audit quality differs between and within audit firms. Hence, it is wrong to attribute audit quality to firms on the basis of their size, irrespective of the fact that larger firms have more resources. Given the stage in Libya's development, no consensus has yet been reached on this issue.

3.7.2 The Provision of Non-Audit Services (NAS)

Since the early 1980s, the work undertaken by audit firms has gradually changed such that the revenue from audit services has fallen, while that from the provision of other services has increased (Abu Bakar et al, 2005; Abdel-Khalik, 1990; Craswell, 1999; DeFond et al, 2002; Firth, 1997a). This trend has caused some major worries, concerned with the pricing of individual services where the auditor performs several different services, and there is potential for compromising auditor independence. Types of NAS, their characteristics and the empirical studies that have identified their relationship with audit quality are now considered.

3.7.2.1 Definition of Non-Audit Services (NAS)

The AICPA defines Non-Audit Service (NAS) as: "... the function of providing professional advisory (consulting) services, the primary purpose of

which is to improve the client's use of its capabilities and resources to achieve the objective of the organisation" (cited in Patten and Nuckols, 1978).

There has been extensive debate (e.g. Barkess and Simnett, 1994; Canning and Gwilliam, 1999; DeFond et al, 2002; Firth, 1997a) on the merits of audit firms providing non-audit services, the main concern being that NAS is normally expressed in terms of economic dependency and mutuality of interest, and this is why audit fees must be disclosed in annual reports. If NAS become sufficiently important, either in total or in relation to an individual client, the economic dependence of the audit firm on these services and clients may result in the loss of impartiality and objectivity (Simunic, 1984).

In the USA, prior to the Sarbanes-Oxley Act (SOA) of 2002, confusion existed regarding the types of NAS that it was permissible for external auditors to perform for a public corporation, and in fact, some of the major auditing firms have sold their consulting units in recent years in order to avoid any possible conflicts of interest. The SOA attempts to remove any possible conflicts of interest arising from the provision out of NAS, by giving more power to the audit committee. The SOA explicitly prohibits large scale, big fee financial information systems' design and implementation, and IT work. These have been very high profit areas for the large auditing firms. Additionally, it prevents internal audit outsourcing and 'expert' services. Within this context, the following nine activities are prohibited:

- 1) Bookkeeping or other services relating to the accounting records or financial statements of the audit client.
- 2) Financial information systems' design and implementation.

prepared to jeopardise this in surrendering to any particular client's demands to overlook financial problems.

The economic theory of auditor independence that postulates the potential for compromise of independence where incentives to do so are present, was tested by Chung and Kallapur (2003), who used a sample of proxy statements from 1,871 Big Four clients, to determine ratios of client fees to total audit firm revenue (to establish economic dependence) and the ratio of the clients' NAS services fees to total audit firm revenues. Regression techniques revealed no association between abnormal accruals and the client importance ratios, providing evidence that is inconsistent with the economic theory of auditor independence, but that is in line with the arguments of Goldman and Barlev (1974), who assert that NAS increase an auditor's value to the client, thereby placing the auditor in a stronger position to resist client pressure. Chung and Kallapur (2003) obtained similar findings to those of Mitra (2007), who conducted a cross-sectional regression analysis of abnormal accrual adjustment of oil and gas companies, finding that abnormal accrual adjustments were not related to fees paid for NAS. Mitra (2007) argues that industry specialisation and reputation protection are sufficient incentive to ensure auditors remain independent and that they actually strengthen independence. All of these research studies, concur with the review of the NAS literature made by Francis (2006), that suggests there is no direct evidence that audit quality is compromised by the provision of NAS to audit clients. Santan (2007), in a recent study, also finds no support for the SEC's contention that the provision of NAS places audit quality and auditor independence at risk.

3.7.2.4 The Provision of Non-Audit Services (NAS) and Audit Quality

The literature on the effect of joint audit and NAS provision on audit quality has been analysed from two perspectives.

Firstly, as noted by Canning and Gwilliam (1999) surveys of accounting information users have generally found that the joint provision of audit and NAS is considered a threat to independence, essentially because auditors may be reluctant to criticise the work conducted by their consultancy divisions, since this may result in the loss of revenue for the audit firm. Other incentives to compromise are reported as economic dependence on major clientele, and the business relationship with audit clients (Porter et al, 2003). Consequently, audit and NAS fees are generally used in studies of auditor independence (Ashbaugh et al, 2003; DeFond et al, 2002; Frankel et al, 2002; Gul et al, 2003; Watts and Zimmerman, 1983). Since the collapse of Enron, this whole area of the provision of NAS and auditor independence has become a burning issue in research studies (Klein, 2003). But it is possible that even if auditor independence is reduced by the provision of NAS, the overall outcome on audit quality may be beneficial if there is a greater potential for discovering deficiencies.

The second approach has been to examine the influence of NAS provision on audit reporting (Abdel-Khalik, 1990; Barkess and Simnett, 1994; Canning and Gwilliam, 1999; Chung and Kallapur, 2003; Craswell, 1999; DeAngelo, 1981b; DeBerg et al, 1991; DeFond et al, 2002; Firth, 1997a, 1997b; Lennox, 1999b, 1999c; Palmrose, 1986b; Simunic 1980, 1984; Wines, 1994) because

auditors can decide whether to disclose deficiencies by giving clean or qualified opinions. Hence, audit reports are used as a measure of quality.

In an analysis of pricing and independence issues associated with the provision of NAS by auditors in the Australian business environment, Barkess and Simnett (1994) used a sample from the Top 500 publicly-listed companies in Australia for each of the years from 1986 to 1990. The study sample consisted of 371 companies in 1986, 403 in 1987, 466 in 1988, 463 in 1989, and 391 in 1990, and the results showed no relationship between the level of NAS and the type of audit report issued.

Wines (1994) investigated potential impairment to auditor independence where a higher level of NAS was provided, and analysed 76 audit reports of public companies listed on the Australian Stock Exchange as at 30th June 1980 by dividing the type of audit report into non-qualified and qualified. The results demonstrated that companies not receiving an audit qualification of any type derived a significantly higher proportion of their revenue from NAS fees than company auditors receiving at least one audit qualification. Hence, the potential exists for auditor independence impairment when higher levels of NAS are provided to audit clients. Wines (1994) also suggested that financial statement users, reasonable observers and other interested parties might conclude that it was the higher average level of auditor fee gained from the NAS revenue that made companies fall into the non-qualified category and that auditors were less likely to qualify a company's financial statements when higher levels of NAS fees were derived. The inconsistency between the results obtained by Barkess and Simnett (1994) and Wines (1994) is explained by the

fact that whilst both studies were undertaken simultaneously and in the same country, the sample size might have had an influence. Indeed, Craswell (1999), who investigated whether NAS provision impaired independence by testing the relationship between that and auditor reporting opinions, using publicly-available information for 885 Australian listed companies, and time-series data (1984, 1987 and 1994), which was then regressed, found no support for the argument that NAS posed a threat to auditor independence in each of the tested years. This outcome is also consistent with Palmrose's (1986b) findings that based on the widespread use of incumbent auditors for NAS, clients perceived they were generally better off, or no worse off, with the joint supply of audit and NAS.

Furthermore, in a later study conducted in the UK, Firth (1997b) developed a model to explain company decisions to commission NAS from the auditor. The model was tested with data observations from the 500 largest British industrial listed companies, as ranked in The Times 100 financial statements for the year ended 1993. The author suggested that companies that face potentially high agency-costs purchase relatively smaller amounts of NAS from their auditor, and require independent audits in order to reassure investors and creditors.

Using a different methodology and sample, Canning and Gwilliam (1999) investigated the effects of the provision of NAS on perceptions of auditor independence within the Irish commercial environment. They used a postal questionnaire, and semi-structured interviews, to obtain both breadth of coverage and the chance to probe further, finding that perceptions of auditor independence significantly dropped when NAS were provided to clients by

personnel involved in the audit rather than by either a separate department within the audit firm or a completely different firm. The results revealed that users of financial statements were willing to accept some reduction in auditor independence arising from the provision of NAS if this resulted in firms obtaining a higher standard of audit, or better or more cost-effective advice. Clearly, it can be seen that results vary according to the samples and methods used by researchers.

In a study by Lennox (1999b) the effect of NAS on audit quality was examined using the relationship between early disclosure and the fraction of equity owned by company directors, the relationship between financial distress and early disclosure, and the relationship between disclosed NAS and audit qualification. A negative relationship between early disclosure and directors' shareholdings, and between disclosed NAS and audit qualification, was found, whereas the relationship between financial distress and early disclosure was a highly positive one. The association between the provision of NAS and other events of interest encouraged researchers (such as DeBerg et al, 1991) to investigate the effects of the provision of NAS on the auditor-client relationship using archived disclosures mandated by ASR No 250, which was only in effect between 1978 and 1982. No relationship was found between decisions to change auditors and NAS provisions, thereby justifying concerns that audit firms may attempt, possibly to the detriment of independence, to retain high NAS clients. Immediately after a change of auditor, clients were found to purchase a lower proportion of NAS from the new auditor, an occurrence which the authors suggested, might have been the outcome of a

wish to reduce total professional fees or of a reservation about involving the auditor in NAS provision until a close relationship had been established.

It has been accepted that when auditors act as consultants they may be scrutinising their own work and developing mutual interests with the client's management (Panel on Audit Effectiveness, 2000). Furthermore, because in these cases they are serving the interests of management and not shareholders, they may also suffer fiduciary conflicts of interests (Gore et al, 2001).

Interestingly, however, inconsistencies are still found in the research evidence, since whilst Frankel et al (2002) reveal a positive relationship between NAS fees and discretionary accruals, and a propensity for reporting a small earnings surprise, thereby arguing for the separation of audit and NAS in order to enhance auditor independence, Ashbaugh et al (2003) replicating this study of Frankel et al (2002), but controlling the measures of discretionary accruals with firm performance, found outcomes that were in direct contradiction.

From the literature reviewed so far it is clear that NAS provision by auditors to their audit clients is considered as a threat to auditor independence by regulators in many countries around the world, and understandably much research effort has centred on evaluating the nature of this threat and its potential for causing problems for auditors and users of financial statements. Evidence has been obtained by using all manner of research instruments, but consistently there are conflicting results, and it is also accepted that the theoretical relationship between NAS and audit quality is ambiguous. Hence, it is hard to draw conclusions from these sources regarding the provision of NAS to audit clients. The arguments amongst theorists also emerge in empirical

works which do not completely agree with the notion that the provision of NAS to audit clients damages auditor independence (DeFond et al, 2002), but of course it is also asserted that any evidence that shows impairment to auditor independence should be taken seriously (Canning and Gwilliam, 1999), and indeed actual damage to independence in appearance has been documented (Wines, 1994). As a result, some developed countries stipulate the need to disclose the nature of NAS provided and the fees received from them in annual reports.

3.7.3 Length of Audit Tenure

As there is only limited empirical evidence to support a relationship between audit firm tenure and the level of audit quality (Johnson et al, 2002), it is not clear whether the problem at which mandatory rotation is aimed as a solution is an actual or merely a perception. The idea of mandatory rotation and its potential association with audit quality is now discussed.

3.7.3.1 Length of Audit Tenure and Notion of Mandatory Audit Rotation

As reported by Hoyle (1978), the idea of mandatory rotation was introduced in June 1976 by Ralph Nader and other members of the Corporate Accountability Research Group (CARG), who called for congressional legislation that would require many public corporations to change external auditors on a five-yearly basis. It has since been argued by some researchers that auditor tenure is influential in audit outcomes (e.g. Jackson et al 2008; Arrunada, 1997; Sandra et al. 2007 ; Dopuch et al, 2001; Geiger and Raghunandan, 2002; Hoyle, 1978; Shockley, 1981a; Vanstraelen, 2000; Turner et al 2008), while others disagree,

and differences exist in the regulatory framework in different countries. For instance, in Italy and Greece, rotation rules are in force, whilst other legal systems have allow a free choice of auditors, for example, the USA, UK, Germany, France, etc. (Arrunada, 1997).

3.7.3.2 The Benefits of Mandatory Audit Rotation

As the relationship between auditor and client is believed to change with the provision of NAS, so too it is expected to change as the association between auditor and client lengthens. Consequently, the implementation of mandatory rotation for auditors is often introduced as a means of averting actual or perceived weaknesses in auditor independence. Many researchers (e.g. Brody and Moscové, 1998; Deis and Giroux, 1992; Hoyle, 1978) have suggested that audit quality is enhanced by the periodic change of auditors since such rotation enables a fresh approach to be introduced to the audit process and prevents the auditor from becoming too relaxed in the process. The creativity that is often evident in the early years of an audit engagement usually wanes with long tenure, and the auditor starts to anticipate the condition of the client's systems and the presence of control procedures (Brody and Moscové, 1998). Additionally, the periodic change of auditors injects competition into the audit market, thereby creating the conditions for audit quality as different firms compete for contracts. Simultaneously, this situation sends the message to audit firms that they cannot become reliant on a contract, and hence the issue of economic dependence is removed. In such circumstances auditors are better placed to disagree with management over proper accounting principles and auditing standards (Hoyle, 1978).

Also, periodic auditor change allows audit firms to check each other's work, and there is a strong likelihood that accounting and auditing errors would be discovered quickly by newly-appointed auditors rather than being continued over many years by the same audit firm. There is also potential for psychological advantage to be gained because audit firms know that they are themselves to be audited at some point in the near future, and hence are encouraged to produce quality audits (Sori, 2005). Furthermore, the physical act of rotation adds to the appearance of auditor independence (Abu Bakar et al, 2005; Alleyne and Devonish, 2006), even if actual independence is not damaged by a lack of rotation (Winters, 1976). As a confirmation of this contention, Sandra et al (2007) found that MBA and law students were more prepared to make personal investments in corporations where such rotation was in operation. They also found that whilst audit firm rotation appeared to enhance the perception of auditor independence, the rotation did not change the level of confidence in reported earnings.

On this theme of mandatory rotation, Brody and Moscovice (1998) mention two benefits, these being: (1) its contribution to auditor objectivity by not allowing the situation of the auditor becoming too familiar with a client's system, and (2) its contribution to control processes, and to the development of favourable impressions among users of audited financial statements.

3.7.3.3 The Drawbacks of Mandatory Audit Rotation

On the other hand, however, some researchers highlight disadvantages to the practice of mandatory rotation (Hoyle, 1978; Summer, 1998) pointing out that short audit engagements are often not appropriate for large complex businesses

since it takes time for the external auditor to become fully acquainted with the company's audit needs. Hence, it is not expected to see the best audit work in the first few years of a contract. Additionally, mandatory auditor rotation has the potential for companies to shop around for opinions with audit firms being engaged on the basis of how likely they are to give an unqualified opinion, rather than on their audit service quality. Moreover, where an audit firm also provides NAS, there would be an adverse effect on these other services.

As clients have responded to advice from their audit firms in respect of their development of more efficient internal control systems and working on capital budgeting projections, there is a strong danger that the restriction of the audit firm to a specified period would remove the time necessary to gain sufficient insight into the operations of the business, unless the former audit company were able to continue with the provision of NAS separately. Clearly, whilst some NAS work could still be undertaken, the larger, more complex problems facing management might become impossible for the audit firm to accept. In the same context, Johnson et al (2002) argued that audit effectiveness is precipitated by audit firms' accumulated knowledge and long-term experience of a client's operations and complicated reporting issues, and that mandatory rotation would deny this opportunity. Additionally, a smaller amount of client-specific knowledge in the early years of an engagement may result in a lower likelihood of detecting material misstatements, thereby providing non-rotating auditors with a comparative advantage in detecting errors over time as they obtain a deeper understanding of the client's business (Beck et al, 1988).

The issue of cost is also considered as a disadvantage since as Hoyle (1978) highlighted, the possibility of having to relinquish a contract would suggest unpredictable future revenue, and may well lead to an increase in hourly charges (Hoyle, 1978). Consequently, high audit costs would rise significantly in order to underpin the initial audit engagement that demands a complete study of the client company, which translates into additional chargeable hours. In non-mandatory environments, such start-up costs are incurred only occasionally, whereas mandatory rotation implies the periodic payment of an extra large audit cost (The Commission on Financial Services and Insurance, 2005). Discussing this issue of cost, Arrunada (1997) states that the effect on cost and price derives from two sources. Firstly, rotation causes a direct increase since both explicit and implicit start-up costs are incurred more frequently and earlier. The substantial amounts of costs of initial audits are increased with each rotation. Secondly, where rotation is required, the pattern of competition with the market changes dramatically, and the incentive to compete is reduced because audit firms that excel find themselves losing ground periodically.

Moreover, the imposition of mandatory auditor rotation may negatively impact upon earnings quality and lead to lower audit quality (Myers et al, 2003). Another perceived disadvantage (Ghosh and Moon 2005) indicate that mandatory rotation may introduce unintended costs to capital market participants. Limiting auditing years may impair the learning curve development of predecessor auditors and client firms may not ensure the competence of successor auditors. Thus, mandatory auditor rotation may increase costs for both clients and auditors (see, for example, Fearnley et al.,

2002; GAO, 2003) because management may face time-consuming and expensive procedures for selecting new auditors and familiarising them with firms' systems.

From what has been seen thus far, there is no consensus within the literature on the role of audit tenure in audit quality. Supporters of auditor rotation argue for the need to sustain auditor independence to assure quality reporting (e.g. Brody and Moscovice, 1998; Deis and Giroux, 1992; Hoyle, 1978), while opponents of this practice have little faith in its ability to promote auditor independence (Winters, 1976). Arrunada (1997) argues that compulsory rotation is not justified by its effects on audit quality, since it is likely to damage the two main determinants of quality, these being, the auditor's technical competence (i.e. the ability to detect irregularities in financial statements), and the auditor's independence (i.e. the willingness to disclose in reports any irregularities that may have been detected).

3.7.3.4 Length of Audit Tenure and Audit Quality

Many researchers have been attracted to the impact of audit tenure on audit quality as an issue for empirical investigation (e.g. Jackson et al, 2008; Shockley, 1981a; Bae et al , 2007; Arrunada, 1997; Turner et al, 2008; Geiger and Raghunandan, 2002; Myers et al, 2003; Chen et al, 2008), since they recognise that engagement over a long period promotes an emotional relationship from which strong feelings of loyalty may develop, and that consequently might impair auditors' professional judgement, and hence audit quality (Flint, 1988).

Jackson et al (2008) found audit quality to increase with audit firm tenure, when proxied by the propensity to issue a going-concern opinion, and that it remains unaffected when proxied by the level of discretionary accruals (DA). These researchers suggested that audit quality is not improved by the imposition of mandatory audit. Moreover, the initial costs associated with the start of each rotation place unnecessary financial burdens on both the auditor and the client, which can themselves cause much stress.

Commenting on the depth of an audit relationship, Chen et al (2008), researching in Taiwan, found that audit quality improves with audit partner tenure (making a comparison with the years before mandatory rotation – 1990-2001), and that the disadvantages of mandatory rotation are partially ‘managed’ by organisations rotating back and forth with just two audit firms that they maintain a good relationship with whether they are in their period of engagement or out of it.

Short tenure may clearly be problematic for the reasons indicated. In this respect, Anthony et al (1999) produced a model representing the tenure-audit quality relationship in mandatory auditor rotation, as presented in Figure 3.4, which shows the auditor’s ability and professional conduct as the major factors affecting performance. Economic incentives and market structure have endogenous relationships with both performance and tenure. The implication is that the evaluation of the usefulness of mandatory auditor rotation is a complex affair, involving more than a simple association test of audit tenure and audit quality, since audit failure arises from a mix of factors including those other

than tenure, not least of which are variables concerned with national and cultural differences.

Figure 3.4: Tenure-Audit Quality Framework

In a study conducted by Shockley (1981a), the perceptions of audit firms and two groups of financial statement users were examined in relation to independence and tenure. Certified public accountants, represented by partners from large national (Big Eight) audit firms and partners from local audit firms, and financial statement users, represented by commercial loan officers and financial analysts, were involved. It emerged that whilst each variable was potentially influential on the respondents' perceptions, and that the direction of impact could be predicted, tenure did not appear to have a significant impact on perceptions of independence. Copley and Doucet (1993a) later found that the probability of receiving a substandard audit increases with the length of the

auditor-client relationship, using the quality of governmental audit service measurements. However, using the Quality Control Review (QCR) findings of small independent audit firms in Texas to obtain a relatively more direct measure of audit quality between 1984 and 1989, by testing whether audit quality decreased as auditor tenure increased, Bae et al (2007), examined whether mandatory auditor retention affects audit quality, measured by discretionary accruals (DAs) and frequency of modified audit opinions, using the mandatory auditor retention law of Korea as a real-world setting. Proponents of mandatory retention argue that it improves auditor independence, and thus audit quality, and that audit failures are less likely with it. Myers et al (2003), as auditor tenure increases, auditors place greater constraints on the degree of discretionary and current accruals allowed by management. These results suggest that mandatory audit firm rotation may have adverse effects on audit quality, as audit quality is lower in the earlier years of the auditor-client relationship.

Deis and Giroux (1992) found that audit quality declined with the length of auditor tenure. Importantly, although past studies demonstrated that brand name is a useful surrogate for quality differences among auditor size groups, this study suggested that quality differences within an auditor size group are more complex. Deis and Giroux (1992) attributed such decline to either opportunistic behaviour or complacency, whereas the timelier audit reports are of higher audit quality and audit quality improves with increased audit hours. This last result supports Palmrose (1986b) in his argument that audit hours could be an acceptable surrogate for audit quality.

Mandatory rotation of corporate auditors has been proposed at European Union (EU) level in order to improve audit quality, so Arrunada (1997) theoretically analysed the effect of such a requirement on audit cost and quality, asserting that rotation would increase the cost of audit, and consequently the cost of fees, which in turn would bring the depletion of specific assets and the distortion of competition. He also noted that a negative impact on audit quality was likely because of the lower technical competence of auditors and fewer incentives for independent behaviour, at least for diversified auditors. Vanstraelen (2000) studied the annual accounts of two main samples, these being non-bankrupt but financially-stressed large companies, and financially non-stressed non-bankrupt large companies, submitting to the Belgian National Bank between the years 1992-1996. He considered the impact of renewable long-term audit mandates on audit quality, from the perspective of the external users of the financial statements and queried whether renewable long-term audit mandates are influential upon the reporting behaviour of auditors and independence, through the following two hypotheses: (1) the longer the auditor-client relationship, the less likely the auditor will be to issue an unclean audit report (qualified opinion, adverse opinion or disclaimer of opinion), all other things being equal; and (2) auditors are more willing to give an unqualified opinion in the last year of their official mandate compared to previous years, all other things being equal. The results from this study suggested that long-term auditor-client relationships substantially increase the probability of an auditor issuing an unqualified audit report, and pointed to the auditor's willingness to qualify an audit report.

Vanstraelen (2000) believed that as tenure was a significant variable in both financially-stressed and financially non-stressed firms, the probability of long-term tenure decreasing the chances of an unclean audit report. Additionally, a significant difference emerged between auditor reporting behaviour in the first years and the last year of the audit contract, thereby suggesting that auditors were more willing to issue a clean audit report in the first two years of their official mandate than in the last year, presuming that the decision to renew or cancel the auditor's mandate is already known to the auditor before the last audit report within the current mandate is already. The implications of these findings suggest that mandatory auditor rotation is necessary in order to maintain the value of an audit for external users.

Experimental methods are potentially useful when archival data are not available, since these allow researchers to focus on the impact of mandatory rotation constraining constant market, legal, and other institutions, and possibly auditors' willingness to compromise their independence. Such methods were used by Dopuch et al (2001) to assess whether mandatory rotation and/or retention of auditors increases their independence by reducing their willingness to issue reports that are biased in management's favour. These researchers compared auditor reporting across four regimes: one that did not require either rotation or retention; one requiring retention only, one requiring rotation only, and a final one that required both rotation and retention. It emerged that in the third and fourth regimes auditors' willingness to issue biased reports was decreased, relative to the two regimes in which rotation was not imposed. Where both retention and rotation were required, the lowest occurrence of

biased reports occurred. These outcomes give weight to the idea that auditor independence is increased by mandatory rotation.

Some researchers have, however, found no association between long tenure and reporting failures. Geiger and Raghunandan (2002), for example, analysed prior audit reports for a sample of companies entering into bankruptcy during the period 1996-1998 by testing the relationship between the type of audit opinion issued on the financial statements immediately prior to bankruptcy and the length of auditor tenure. A significant audit reporting failure was seen to occur in the earlier years of the auditor-client relationship than when auditors had served those clients for a longer time. Hence, it was more likely to see audit reporting failures in the early years of an audit contract than in the later years, thereby removing the need for mandatory rotation. Additionally, an alternative explanation was given by the authors for their results. They assumed that over time, auditors would benefit by the increased knowledge they gained about their clients' operations and business processes and be in a better position to judge management plans as their tenure increased, thereby making them more likely to issue a going-concern modified audit opinion.

Turner et al (2008) also found audit quality to improve with increased partner tenure. They controlled for client size and engagement risk, finding that audit partner tenure was significantly and negatively associated with estimated discretionary accruals only for small clients with partner tenure of greater than seven years, irrespective of risk level.

Johnson et al (2002) conducted a similar study in which they investigated the association between short and long audit tenures with financial reporting

quality. They adopted two proxies for financial reporting quality: the absolute value of unexpected accruals to proxy for the extent of management interventions in reported earnings figures, and the extent to which current accruals persisted into earnings in the subsequent year as a proxy for the quality of accruals reported in current period earnings. An industry- and size-matched sample of publicly-traded companies audited by the Big Six audit firms, which had been audited by the same firm for two to three (short tenure), four to eight (medium tenure), or nine or more (long tenure) years, provided the research population. Evidence of greater management intervention in reported earnings and lower-quality accruals was reported for short audit-firm tenures. However, in contrast, there was no evidence that long tenure (nine years or longer) was associated with reduced financial reporting quality relative to the medium auditor-client relationship.

As a means of overcoming the disadvantages of long audit tenure, the AICPA (1992) proposed mandatory periodic auditor rotation. Gietzman and Sen (2002) contend that the rotation of audit firms may play a positive public policy role. The Sarbanes-Oxley Act 2002 requires that the lead and concurring audit partner rotate off the audit engagement after a period of five years. Audit partner rotation may be a good alternative to audit company rotation since the knowledge of a client's business may remain within the same audit firm and may prevent the problem of insufficient audit firms (Bates et al, 1982; Teoh and Lim, 1996). According to Carey and Simnett (2006) audit quality suffers once an audit partner's tenure exceeds seven years.

Consequently, auditor rotation has the advantage of bringing a fresh auditing perspective. Auditors will no longer be dependent on any one client and management's ability to change the auditor on a whim will no longer be considered a threat for them (Gietzman and Sen, 2002). Auditors can perform auditing work for each audit engagement in accordance with professional standards and without client retention pressure. Auditors are expected to be responsible to public stakeholders such as shareholders, investors, creditors, and government. Mansi et al (2004) report that longer audit firm tenure is related to higher bond ratings and a lower cost of debt, and Ghosh and Moon (2005) find it to be associated with greater value-relevance of reported earnings and higher Standard and Poors' ratings of the client's shares.

Knapp (1991) investigated the effect of the length of audit tenure on the potential for an auditor to discover material error (discovery assessment) and the possibility that the auditor would require the client to correct the error and, in the event of a refusal by the client, report the error in the audit report (disclosure assessment). The results indicate that length of auditor tenure significantly affects discovery assessments, although the Big Eight were viewed as more likely to disclose. On the other hand, a negative relationship was found between length of tenure and the perceived likelihood that auditors would discover material errors between five and twenty years.

From all these studies, it is clear that a learning curve effect in the early years of an auditor-client relationship seems to create a gradual improvement in auditor quality, and that it is not always the case that a negative correlation develops in the later years. However, where it does, this is interpreted as the

outcome of complacency by the auditor, an over-reliance on the information provided by the client, and less rigour.

As a result, the issue of whether to rotate or not still remains. But it must be recognised that the independence of the auditor is not the only reason for adopting the practice of rotation. In this respect, Winters (1976) suggests that the decision as to whether to rotate depends on the costs and benefits to clients in the broadest terms. Moreover, if the culture of the audit firm is such as to place pressure on its partners to retain clients and bring more business, the rotation might not make a difference (George 2004). To this end, a concentrated research effort on the auditor rotation question should be undertaken by the profession. Such an evaluation could well decide this and solve other current problems, such as the nature and extent of the auditor's responsibility to the various parties served. Hoyle (1978) argues that outside readers of financial statements should receive more specific assurance that the auditor has properly carried out his responsibilities, and mandatory rotation is not the best means for achieving better auditing.

3.7.4 The Level of Competition in the Audit Market.

In relation to the impact of competition (number of bids received) for audits based on the quality of resulting audits, as conventional wisdom suggests, increased competition and resulting pressure to minimise audit fees have contributed to poor quality audits, whereas economic theory generally predicts a positive relationship between competition and quality. Copley and Doucet (1993b) found that entities receiving a greater numbers of bids for their audit engagements were significantly more likely to receive an audit of acceptable

Moreover, the suggestion that excessive competition would result in clients changing auditors, was also rejected by Beattie and Fearnley (1998), who found that whilst the level of audit fees was frequently reported as the main reason for auditor switching and served as an influencing factor in the selection of new auditors, it was not considered as the main priority in the selection of an audit firm. In fact, their investigation discovered that audit fees were significantly less important for companies that did change auditors. The issue of fee discounting seems to be confined to the small audit companies (Ghosh and Lustgarten, 2006), because the competition among them is high, they are more likely to negotiate on fees than are the bigger audit firms, in their efforts to attract new clients.

In a recent Middle Eastern study, Al-Mogbel (2006) discovered that despite a very competitive Saudi audit market, an unhealthy situation has arisen in the price war which has had a large negative impact on local firms that are not affiliated to the larger foreign firms.

On the issue of direct solicitation and direct uninvited solicitation activities from auditors and its relationship with audit quality, there has been much research (Blair and Kaserman, 1980; Chaney et al, 1995; Chaney et al, 1997; Chaney et al, 2003; Hay and Knachel, 2003). In this respect, Blair and Kaserman (1980) formulated a model to show that in the absence of competition, audit quality would increase, and that auditor income would subsequently increase, thereby bringing a quality safeguard. More recently, Chaney et al (1995) found no evidence of an association between the incidence of auditor alignment from non-Big Eight to Big Eight audit firms and direct

Based on the above literature, it can be seen that inconsistencies arise from previous research with regard to the effect of competition on audit quality. Some research has shown that a high level of competition in the audit market was perceived as a potential threat to audit quality and auditor independence. Contrary to these results, other studies revealed that audit quality was not affected by competition. Moreover, it is observed that this perception, i.e. a positive effect on audit quality, was based on the assumptions of economic theory that generally predicts a positive relationship between competition and quality. Accordingly, more research on this area would provide a better understanding of the inherent societal values within which auditors perform their work, and would assist in explaining why some actions or behaviours of auditors might exist.

3.7.5 Fees for Audit Services

In many studies, the fees for audit services have been examined as a factor influencing audit quality (see, for example: Jensen et al 2005; DeAngelo 1981; Abbott et al. 2003; Simunic 1980; Levitt 1996).

3.7.5.1 Fees for Audit Services and Audit Quality

Deis and Giroux (1992), studying the effect of auditor changes on audit fees, audit hours and audit quality, discovered that the number of audit hours represented an acceptable surrogate for audit quality differences among audit firms of similar size. They argued, based on their later study (1996) that it was also possible to link audit hours with audit fees, asserting that where the audit effort declined with audit fees on initial audits, audit quality also declined,

although, in their 1992 study, audit hours also emerged as a suitable surrogate to measure audit quality. More recently, Jensen et al (2005) found evidence that well-developed audit-procurement practices have a minimal combined effect on audit fees, but that individual audit-procurement elements are associated with audit fees.

Over the past years, there has been increased scrutiny of the auditing profession because of the increasing levels of NAS fees received from audit clients and the potential unfavourable influence of these fees on auditor independence, and hence audit quality (Levitt, 1996). Such concerns in this respect have already been discussed earlier in this chapter, and were the main reason why the SEC issued revised auditor independence rules in November 2000, since when it has been a requirement for firms to disclose, in proxy statements filed on or after February 5th, 2001, the amounts of all audit fees and NAS fees paid to them. Hence, the association between audit fees and audit quality could be considered as depending on two main different perspectives: firstly, the potential negative impact of non-audit fees received from audit clients on auditor independence, and hence the level of audit quality (Levitt 1996), and secondly the relationship between audit fees and audit hours (Palmrose, 1986b).

Simunic (1980) conducted the most influential empirical study in this field, by comparing audit pricing for large clients with that for small clients, and making inferences regarding the extent of competition and/or economies of scale/product differentiation on the basis of this comparison. In Simunic's study, a stratified sample of 1,207 companies was mailed during 1977 with a

questionnaire addressed to the principal financial officer of the company. This effort achieved a 33% response rate, the main finding being that no price premium was associated with Big Eight auditors in either the large or small client sub-market, and hence, differences in Big Eight concentration across the market were irrelevant to the determination of audit prices. This effort by Simunic (1980) prompted many derivative studies, but contrary to its results, the study conducted by Francis (1984), using Australian data, found a large firm price premium in both large and small audit sub-markets. It should, however, be noted that substantial size differences were evident in the sample companies. Francis (1984) concluded that the observation of systematic price differentials between large and small audit firms represented product differentiation in the Australian audit services market, and that more importantly, higher prices were consistent with higher quality audits.

A study that had the same objectives of that undertaken by Francis (1984), was conducted by Rushinek and Rushinek (1990) in the US, and similar observations were made. Additionally, Gist and Pavlos (1995) found large firm premiums in their total sample, but not in the large client sub-sample, a feature which prompted the authors to offer three plausible explanations for the absence of an observed pricing difference in the large client sub-sample. Firstly, they suggested that higher monopolistic pricing is offset against lower pricing due to the scale economies enjoyed by Big Eight firms when auditing large clients. Secondly, they suggested that non-Big Eight firms met diseconomies of scale in the audits of large clients; and thirdly, they introduced the possibility that smaller audit firms are price followers while large firms are monopolistic price setters. However, they rejected their last explanation, given

the observed price differential in the small client market, which is assumed to be competitive. Whilst they recognised that the methodology used could not distinguish between the two other competing hypotheses, they did claim that the results did not appear to be inconsistent with monopolistic pricing behaviour.

Simon (1985) was another researcher who replicated the study of Simunic (1980) by testing the Price Waterhouse premium using a sample of 79 companies in the US market. Simon (1985) found that the experimental variable of Price Waterhouse was positive but not significant, whereas when Palmrose (1986a) repeated Simunic's (1980) study he found contrasting results with both that study and with Simon's (1985). Palmrose (1986a) used Simunic's 1977 data and compared this with US data from 1980, and was able to report a premium for the Big Eight, but not for industry specialists. In more recent research, Abbott et al (2003) point out that independent and knowledgeable audit committees are associated with higher audit fees.

3.7.5.2 Fees for Audit Services in Developed Countries

The research efforts in developed countries, such as the USA, the UK and Australia, are differentiated by the independent variable chosen. Simunic (1984) considered clients' purchase decisions in respect of audit and NAS when production functions were interdependent, and he tested for the existence and pricing effects of knowledge externalities or external economies. He took data from 263 observations of audit fees and other characteristics, and NAS fees, in publicly-owned USA companies, representing a stratified random sample, finding most importantly, that the purchase of NAS from the auditor

was associated with a significant increase in the audit fee. Barkess and Simnett (1994) later found the same results. However, such outcomes were not obtained by Firth (1997a), who analysed the determinants of audit fees and the derived explanatory models used to predict future fees. He took a sample of companies listed on the Oslo Stock Exchange in 1991 and 1992, reporting a negative relationship between audit and consultancy fees, according to whether the audit was used as a loss leader and/or whether there were reductions in audit costs, returned to clients via lower audit fees.

Palmrose (1986b) explored the effect of fees for particular NAS (tax, accounting-related management advisory services and non-accounting management advisory services) on the audit service price, finding a positive relationship in respect of the provision of tax, accounting-related management advisory services, and non-accounting management advisory services. The strongest result pertained to accounting-related management advisory services and the advisory services closest to accounting/auditing concerns. The association was observed from the perspective of whether NAS were provided by the incumbent auditing firm or by another public auditing firm.

Another study conducted by the same researcher (Palmrose, 1989) investigated whether audit fees would change under fixed fees contracting. The sample was comprised of 361 public and closely-held companies, issuing audited financial statements in 1980-1981, and it was concluded that significantly lower audit fees are associated with fixed fee contracts, but that audit hours are not influenced by contract type. It was also observed that fixed fee contracting was more likely to be employed in the early years of auditor-client relations, but

that any pricing unique to initial engagements or price-cutting behaviour was not the reason for significantly lower audit fees with fixed fee contracting.

DeFond et al (2002), exploring the presumption that an auditor's tendency to issue a going-concern opinion is positively related with auditor independence, used a sample of 158 distressed firms with proxy statements that included audit fee disclosures, and included 96 firms receiving first-time going-concern reports. They looked at whether NAS fees are inversely related to the probability of auditors issuing going-concern audit reports, and whether total fees are inversely related to the probability that auditors would do this, but found no evidence of any significant relationship between NAS fees and impaired auditor independence, where the auditor's tendency to issue going-concern reports was used as a surrogate for independence. The economic theory of auditor independence (DeAngelo, 1981a) suggests that incentives to auditors to compromise their independence are related to client importance. Chung and Kallapur (2003), using ratios of client fees and of NAS fees divided by the audit firm's US revenues as a surrogate for the audit-practice-office revenues as measures of client importance, reported no evidence of impaired auditor independence as an outcome of different client fee ratios, either in the full sample (1,871 clients of Big Five audit firms), or in the sub-sample, where encouragements to compromise independence could have been greatest, as suggested by the economic theory of auditor independence. Moreover, no association was evident between going-concern opinions and either total fees or audit fees.

In the same context, Geiger and Rama (2003) investigated the link between the size of audit and NAS fees and auditor report modification decisions in financially-stressed manufacturing companies that filed their proxy statements after 5th February, 2001. They achieved results that demonstrated a significant positive association between the volume of audit fees and the chance of receiving a going-concern modified audit opinion, but they did not indicate any significant association between NAS fees and audit opinion. Moreover, they were also unable to identify any significant relationship between the ratio of NAS fees to audit fees and reporting decisions. Controlling for the potential endogeneity of audit opinions, audit fees, and NAS fees, Geiger and Rama (2003) reported the same positive association between audit fees and opinions, but no association between NAS fees and audit opinions.

Somewhat earlier, Deis and Giroux (1996) examined the influence of independent auditor changes to fees, independent audit effort, as measured by audit hours, and independent audit quality, taking audits undertaken by local audit firms in Independent School Districts (ISDs) in Texas as their sample. Deis and Giroux (1996) found that both audit fees and audit hours were significantly related to audit quality, concluding that audits are differentiated products. They also discovered that both audit fees and audit hours were impacted upon by audit quality, and that audit hours and audit quality were higher in initial audits, thereby adding weight to the earlier conclusion drawn by Raman and Wilson (1992) that independent auditors did not sacrifice quality to secure a new audit client, although lower audit fees were detected in initial audit contracts.

Whisenant et al (2003) undertook similar research, examining whether the characteristics of clients, auditors, and the auditor-client relationship simultaneously determined audit and NAS fees. They considered whether previously documented relationships between audit and NAS fees were the outcome of biased estimation brought about by the use of endogenous variables in single-equation models, but in fact they found no association between audit and NAS fees using simultaneous specification of the fee system.

Gonthier-Besacier et al (2007) came to this issue from a different perspective, finding that audit fees (adjusted for company size) increase with the decision to contract the services of only one of the Big Four firms. Additionally, it seems that an audit fee advantage exists for French companies employing two of the Big Four firms for their joint audit. This reduction in fees billed by two Big Four firms working together may arise from a more balanced sharing of qualifications, skills, and potential risks, between the two.

Gerrard et al (1994) found the best explanatory power as provided by the square root of current assets and the role of internal audit, were not significant determinants for audit fees, and Frankel et al (2002) found that NAS fees were positively associated with small earnings surprises and the magnitude of discretionary accruals, whereas audit fees were negatively associated with these indicators of earnings management. Additionally, they found support for a negative relationship between NAS fees and share values on the date the fees were disclosed, although the effect was small in economic terms. Finally, Bell et al (2001) reported that whilst the audit fee charged per hour remains

unchanged, audit fees increase as assessments of business risk and audit hours increase.

3.7.5.3 Fees for Audit Services in Developing Countries

There are few studies on audit fees and audit quality in developing countries, but there have been some contributions to the literature. With a focus on the Indian audit market, Taylor and Baker (1981) formulated a model to test the relationship between government ownership and audit fee levels for both public and private sector companies. The audit fees for public sector companies were found to be significantly lower than those of private sector companies, and a free premium for the Big Eight audit firms in the Indian audit market was seen to exist. This was also confirmed by Simon and Burton (1999) in the South Korean market, where other variables than firm size, such as complexity were not significant. This is in contrast to the existence of a large audit firm fee premium observed in many other countries (Francis, 1984; Palmrose, 1986a). These variations were considered to be the outcome (Taylor et al, 1999) of the completely different regulatory framework in South Korea, particularly in respect of the fee-setting process.

Simon et al (1992) conducted a similar study across three Asian countries, namely, Hong Kong, Malaysia, and Singapore, to explore the audit fee structure for 1987 and 1988. The sample was comprised of 99 Hong Kong, 132 Malaysian, and 126 Singaporean companies. The logarithm of audit fees was regressed on the logarithm of total assets as a proxy for size, with the logarithm of number of subsidiaries as a proxy for complexity, and the percentage of inventory and receivables to total assets as a proxy for complexity. Whilst

these researchers reported broad similarities across the three sample countries, they found, importantly, a strong demand for quality-differentiated audits in Hong Kong and Singapore, but not in Malaysia, and concluded that national culture might be the reason. A study conducted to consider variation in audit fees charged by local audit firms as opposed to foreign audit firms, was undertaken by Karim and Moizer (1996) in Bangladesh with a sample of 157 companies operating in 1991. It was found that auditors affiliated to foreign audit firms secured higher audit fees than purely local audit firms.

From these limited instances of studies in developing countries, it can be seen that there is little difference between the results obtained, and those found in developed countries. This may be attributable to the fact that all those studies reported on countries which had previously been colonies of advanced countries and hence may have inherited a regulatory framework.

3.8 Implications of the Literature for Libya

Whilst Libya is clearly a developing country, it is nonetheless one that has been colonised by European powers during the 20th century, and since the discovery of oil, and joint ventures with overseas oil companies, it has been closely involved with western general management, and auditing practices, particularly those derived from the US and UK. Consequently, it can be argued that the literature is highly applicable to the Libyan situation since the regulatory framework within Libya bears many similarities to the frameworks in the advanced nations.

3.9 Study Aims and Objectives

Having reviewed the literature, the researcher is able to formulate a robust aim for this study, which is to get an in-depth understanding of the current perceptions of the level of audit quality in Libya. The study's scope of research focuses on concepts of the size of audit firm, the provision of non-audit services (NAS), the length of auditor tenure, level of competition in the audit market, and fees for audit services. This study will be carried out both on the demand side (using Libyan oil companies) and on the supply side (using audit firms working in Libya). The main research objectives are as follows:

- To examine the current perceptions of the level of audit quality in Libya from the viewpoint of oil companies and audit firms.
- To investigate the relationships between selected variables perceived as surrogates of the level of audit quality from the perspectives of Libyan oil companies and audit firms.
- To identify improvements which could be introduced into the Libya auditing environment.
- To make recommendations based on the findings of this study in audit to improve audit quality in Libya
- To contribute to the literature of auditing.

3.10 Summary

This chapter has presented a thorough review of the literature on audit quality and the variables that are known to affect it. Initially, a discussion of auditing – definition, its importance, the demand for it, and its objectives – was presented. Thereafter, an overview has been given of the extensive literature dealing with

audit quality. It is difficult to measure audit quality and consequently, researchers have used various attributes to act as surrogates, for example, firm size, the provision of NAS, auditor tenure, competition within the audit market, and fees for audit service. It has been clear from the survey of the literature that throughout all the studies, conflicting results have emerged on most of the issues highlighted.

There is a consensus that perceptions of audit quality are potentially influenced by the size of audit firms, because these firms possess substantial resources which they can devote to recruitment and training, thereby providing themselves with good calibre staff. Consequently, these personnel are able to implement a sound audit methodology using sophisticated tests that enable them to detect potential errors in financial statements and, for as long as the retention of their reputations remains important, these audit firms will continue to report any such deficiencies. Also, the Big Four possess much larger client portfolios, and are in a better position to resist management pressure than are smaller audit firms, whose independence may be compromised by their need to retain their clients. That said, it is also possible to assert that variations between large and small audit firms are likely to reduce and ultimately disappear with the implementation and maintenance of professional standards and regulations. There appears to be no comprehensive agreement in terms of the relationship between audit quality and the size of audit firm, and undoubtedly there is a case for more research in this area. That argument leads to development of the second question in the current study.

The most widely-debated variable in the field of audit quality and auditor independence is the provision of NAS by audit firms, which has been regarded by regulators in many parts of the world as posing a threat. Not surprisingly, much research effort has been directed towards the assessment of the nature and size of this threat, including the extent of the problem it creates for auditors and the users of financial statements.

Once again, however, there is no consensus in the literature concerning the influence of the provision of NAS to audit clients of auditor independence, but irrespective of whether any impairment of independence is caused, it is the fact that the perception of independence is damaged by the provision of NAS. Over the years it has become a requirement in certain developed countries for companies to disclose in their annual reports, both the type of service provided and the fees associated with those services. In some cases this must be in absolute terms whilst in others it is sufficient to disclose the percentage of the NAS fees in relation to the total audit fees.

Reynolds et al (2004:32) argue that there is a need for more research in this area as “paradoxically, fees paid to the auditor constitute an incentive both for and against objectivity”. It is clear that more research needs to be conducted to resolve the debate over the provision of non-audit services. This debate leads to the development of the third question of the current study.

The issue of mandatory rotation is also a variable that has attracted attention in the literature, specifically whether this is helpful in the achievement of audit quality, or whether it is detrimental to it. Independence, however, is documented as being not the sole consideration when evaluating auditor

rotation, and consequently, this stands as another research topic that requires more research. The results of such research could be decisive in helping to solve other problems that exist such as what responsibility auditors have to the various parties for whom they act. The fourth research question stems from this recognition.

Conflicting results were also reported on issues of competition in the audit market. Some research has shown that a high level of competition in the audit market was perceived as a potential threat to audit quality and auditor independence. In this connection Chaney et al (2003) have suggested that in order to enhance audit quality, regulators or market mechanisms should increase scrutiny and penalties, rather than imposing a ban on competition. Other studies revealed that audit quality was not affected by competition. Accordingly, more research on this area would provide better understanding of the inherent societal values within which auditors perform their work, and assist in explaining why some actions or behaviours of auditors might exist. This raises the fifth research question of this study.

The relationship between audit service fees and audit quality is suggested to be minimal, and little difference was seen to exist between developed and developing countries. This may be because of the effects of their past colonial relationships which have left regulatory frameworks in place. The sixth research question is concerned with this issue.

This literature review has highlighted a number of unresolved problems in the area of audit quality and a number of areas where gaps in the literature occur. There is a great need for more research in this critical area of audit quality. The

following chapter will introduce and discuss the methodology adopted in order to pursue the research questions and thus achieve the aims and objectives of the study.

CHAPTER FOUR

RESEARCH METHODOLOGY

4.1 Introduction

In this chapter, the research methodology and methods employed in the study are described. In the first section, the research strategy is presented. Both quantitative and qualitative methods were used in the study, and the philosophical assumptions that guide the research are discussed in order to justify the chosen methodology. Detailed procedures of the research methods adopted (questionnaire survey and interview methods) are also discussed. The pre-study investigation of the study questionnaire, which was conducted with academic personnel, audit firm and oil company staff in Libya, is then presented. Finally, the difficulties of conducting interviews in Libya, rather than using questionnaires, are explained.

4.2 Research and Philosophical Assumptions

According to Burns (2000:3), research represents “a systematic investigation to find answers to a problem”. Referring specifically to research in business, Sekaran (2003:5) considers this to be “an organised, systematic, data-base, critical, objective, scientific inquiry or investigation into a specific problem undertaken with the purpose of finding answers or solutions to it”. Clearly, both scholars explain the research activity in similar ways.

The cause and effect element of research is highlighted in social research by its attempts to identify, understand and make links between actions, experience and change, and it is asserted (Gilbert, 1993) that three essential components

are required for rigorous social research, these being: formulation of theory, the design of methods for collecting data, and an actual process of data gathering. In this respect, it is important initially to give thought to the research strategy which is appropriate for a given project, and to the way in which the empirical work associated with it will be undertaken. Remenyi et al (2002) make the important point that when considering the overall research plan, the particular questions to be addressed must be properly articulated, and from these clear objectives must be derived. Thereafter, it is crucial to decide upon the research strategy, and in this matter the researcher must determine whether a theoretical or empirical approach (or indeed a combination of the two) will be appropriate. Once the research strategy is formulated, it is possible to develop a conceptual framework for the subsequent study, and having made that particular decision, the methods of data gathering and analysis, referred to by Remenyi et al (2002) as tactics, must be considered.

Prior to considering the overall research strategy, however, a more fundamental exercise relating to the research philosophy is required, and in this respect Collis and Hussey (2003) identify two paradigms – positivist and phenomenological. They describe these as methods of practice that are founded upon people's assumptions about the world and the nature of knowledge. In an earlier commentary on this matter, Cassell and Symon (1994:2) stated that "the assumption behind the positivist paradigm is that there is an objective truth existing in the world which can be revealed through the scientific method, where the focus is on measuring relationships between variables systematically and statistically". In this respect, Holloway (1991) asserted that the social sciences claimed quantification as the way to ensure scientific rigour, since

with reliable and valid measuring instruments, it is possible for a researcher to generalise and clearly predict the effects of the presence of particular variables.

This positivist approach to social research has been defined by Denscombe (2001:299) as one that “seeks to apply the natural science model of research to investigations of the social world”. The assumption is that identifiable patterns and regularities, causes and consequences, exist in the social world exactly as in the natural world (Denscombe 2001). Bryman (2004:11) confirms this position by explaining positivism as “an epistemological position that advocates the application of research methods of the natural sciences to the study of social reality and beyond”. Easterby-Smith et al (2002) note that the central tenet of positivist thought is that objective methods should be used to evaluate social properties, rather than subjective methods involving sensation, reflection or hunch. Scott (1997) also argues that no substantial differences exist between the methods required to evaluate physical and social phenomena. This kind of approach allows for the prediction of phenomena, and consequently the possibility of controlling negative ones. As noted by Collis and Hussey (2003), the identification of causal relationships between variables allows for researchers to link these to existing theory, or create new theory.

From this brief summary of scholars’ ideas in relation to positivism, it is apparent that research methods used in the natural sciences are believed to be suitable for research in the social sciences. Indeed, Collis and Hussey (2003) have suggested that the basic positivist assumption is that studies in human behaviour should be undertaken using the same methods as those employed in

the natural sciences. This belief justifies arguments that social research is scientific

The positivistic approach has, however, been criticised by many writers who believe that it is necessary to define variables before relationships between them can be established, and this requires a recognition that subjects cannot be investigated without reference to their social environments, since it is these that give meaning to their actions and underpin their own perceptions of them (Remenyi 1998 and Mashat 2005). Another criticism is that positivism does not necessarily remove researcher subjectivity, since as Collis and Hussey (2003) note, researchers can easily introduce their own interests and values to the research.

As an alternative to positivism, the phenomenological approach offers the researcher the chance to consider the wider sociological environment, in what Collis and Hussey (2003) still refer to as a science. They note the derivation of the word 'phenomenon' from the Greek verb meaning to appear or show. Adding to the concept of a phenomenon, Allan (1991:893) described this as "a fact or occurrence that appears or is perceived, especially one whose cause is in question".

Clearly, a phenomenological approach to research is in direct contrast with the positivist approach already discussed, since the fundamental premise of the former is that the world is socially-constructed, and does not comprise an objective reality as the positivists assert. Meaning, rather than facts, becomes the focus within the phenomenological paradigm which aims to establish

exactly what is happening, why, and what can be learned from the evidence (Remenyi et al, 2002).

Phenomenology has been considered (Cohen and Manion, 1987) as an approach which allows for the study of direct experience as being the result of other experience, and not as the outcome of some external, objective and physically described reality. Because of this benefit, it is argued that this type of approach is popular with business and management researchers (Remenyi et al, 1998). There is no attempt by phenomenologists to reject the idea that the world can in fact be modelled, but they believe this can be accomplished through the use of a verbal, diagrammatic, or descriptive framework, and do not consider the use of mathematical models to be valuable in this respect.

Consequently, it can be appreciated that phenomenology represents a qualitative approach in which the subjective aspects of human behaviour are considered and where the concentration is on their meaning rather than their measurement. Scholars describe this as the descriptive/interpretive method, believing that through this approach each event can be explored as a unique incident in its own right (Remenyi et al 1998, Collis and Hussey 2003; Mashat 2005).

4.3 Methodology and Data Collection

As mentioned in the introduction to this chapter, this study gathers data through the use of questionnaires and semi-structured interviews, and both of these methods are discussed in detail in the following sub-sections.

4.3.1 Quantitative Research Method

An acknowledged advantage of quantitative research is the fact that large samples can be involved which may allow for a legitimate reflection upon the attributes of the wider population under study. Findings using such an approach may well be assumed to relate to a much bigger population, thus giving great value to the outcome of a study (Sarantakos 1998) in that it makes such an effort representative of greater populations than can actually be involved in the research. As well as providing representativeness, quantitative methods also bring the benefit that they use standard measurements. In this respect, Patton (1990:14) argued that “quantitative methods entail the use of standardized measures so that the varying perspectives and experience of people can fit into a limited number of predetermined response categories to which numbers are assigned”.

4.3.2 Aims and Objectives of the Study

This study aims to get an in-depth understanding of the current perceptions of the level of audit quality in Libya. The study’s scope of research focuses on concepts of the size of audit firm, the provision of non-audit services (NAS), the length of auditor tenure, level of competition in the audit market, and fees for audit services. This study will be carried out both on the demand side (using Libyan oil companies) and on the supply side (using audit firms working in Libya). The main research objectives are as follows:

- To examine the current perceptions of the level of audit quality in Libya from the viewpoint of oil companies and audit firms.

- To investigate the relationships between selected variables perceived as surrogates of the level of audit quality from the perspectives of Libyan oil companies and audit firms.
- To identify improvements which could be introduced into the Libya auditing environment.
- To make recommendations based on the findings of this study in audit to improve audit quality in Libya
- To contribute to the literature of auditing.

4.3.3 Research Questions

As previously stated, the main objective of the study is to understand the current perceptions of audit quality in Libya. Those perceptions are in terms of firm size, the provision of non-audit services (NAS), the length of auditor tenure, level of competition in the audit market, and fees for audit services. Some of the research questions were derived from suggestions made by the focus group of Libyan PhD accounting students at Liverpool JMU, who had sufficient knowledge of accounting in the Libyan business environment. Some were derived from prior studies (Palmrose, 1988; Fearnley et al, 2005; Al Mogbel, 2006; DeFond et al, 2002; Sori, 2005; Arrunda, 1999, 2000 and Lennox, 1999b , 1999c). The following questions have been designed for the research study to answer, in order to achieve the research aims and objectives:

- What are the perceptions of the oil company and audit firm respondents of the current level of audit quality in Libya?
- What are the perceptions of the oil company and audit firm respondents concerning the impact of different sizes of audit firm on audit quality?
- What are the perceptions of the oil company and audit firm respondents concerning the impact of the provision of NAS on audit quality?

- What are the perceptions of the oil company and audit firm respondents concerning the impact of long tenure on audit quality?
- What are the perceptions of the oil company and audit firm respondents concerning the impact of a highly competitive environment on audit quality?
- Is the level of audit quality reflected by the audit fees?
- What can be done to improve the Libyan auditing environment?

4.3.4 The Questionnaire Method

The scope of the research covers concepts of firm size, the provision of NAS, the length of auditor tenure, level of competition in the audit market, and fees for audit services. Empirical work is considered to be important in this type of research, and for this, the researcher used the questionnaire survey method, since a questionnaire was determined to be the most efficient and economical method of collecting data. Saunders et al (2000:278) considered the word ‘questionnaire’ to be a general term to include all data collection techniques that require participants to respond to the same set of questions in the same order. Similarly, Collis and Hussey (2003:173) argued that questionnaires are related to both positivistic and phenomenological methodologies, defining a questionnaire as “a list of carefully structured questions, chosen after considerable testing, with a view to eliciting reliable responses from a chosen sample. The aim is to find out what a selected group of participants do, think or feel”. In the same context, Sekaran (2003:236) defined a questionnaire as a “preformulated written set of questions to which respondents record their answers, usually within rather closely defined alternatives”. Sekaran (2003) viewed the questionnaire as the most efficient and important tool of data collection when the researcher knows exactly what type of information he

needs and how to measure the study variables. The next section will review types of questionnaires in general and those used in the study.

4.3.5 Types of Questionnaire

As a means to gather the information necessary to answer the research questions documented in section 4.3.3, the researcher carried out a survey which covered the concepts of firm size, the provision of NAS, the length of auditor tenure, level of competition in the audit market, and fees for audit services. Haimon (1998) has reported that the use of advanced analytical methods for processing survey data has emerged as one of the foremost procedures of social investigation. Survey research is used to measure population characteristics, and can consequently be valuable both for describing a population, and formulating models that allow for the analysis of characteristics. Hence, survey data has both descriptive and analytical potential.

In considering the value of this approach, Gilbert (1993:95) has reported that “sociologists also regard surveys as an invaluable source of data about attitudes, values, personal experiences and behaviour”. He adds the benefit that such surveys can be conducted through the use of face-to-face or telephone interviews, by sending postal questionnaires. It is also noted that surveys are used to obtain people’s views, beliefs, feelings, and that these may be sought by researchers, either as ends in themselves, or as a means to give weight to some argument they wish to propose (Jankowicz, 1995). The various methods of conducting a survey as noted above have both advantages and disadvantages, which are compared in the following sections.

4.3.5.1 Telephone Interviewing

Interviewing by telephone is cheaper than interviewing face-to-face, costing approximately half (Dooley, 1990). The selection of telephone numbers can be done in various ways (Czaja and Blair, 1996), for example randomly from a telephone directory, or by the researcher's own creation.

4.3.5.1.1 Advantages of the Telephone Interviewing

There are clear advantages to the technique of telephone interviewing which are:

- (a) Random digital dialling sampling of general population.
- (b) Improved chances of accessibility to interviewees when compared to personal interviews.
- (c) Lower cost than personal interviews.
- (d) Shorter data collection periods.
- (e) Easier administration than a mail survey.
- (f) Fewer people required to conduct the survey.

4.3.5.1.2 Disadvantages of the Telephone Interviewing

The disadvantages are:

- (a) It is less reliable in the case of sensitive questions.
- (b) Non-response (associated with random-digit-dialling sampling) is higher than personal interviews.
- (c) Telephone interviewees may produce less good data on income questions.
- (d) Respondents may find it difficult to answer long and complicated questions.

4.3.5.2 Mailed Questionnaires

This technique consists of the researcher distributing questionnaires and covering letters by mail to the selected research sample, and it is usual when using this approach, for the researcher to include a prepaid return envelope, since this improves the participation rate.

4.3.5.2.1 Advantages of the Mailed Questionnaires

The self-administered postal questionnaire is believed to be the most common method. As observed by Sarantakos (1998), the postal questionnaire requires limited interference from the researcher, and has the additional benefit that in comparison with interviews and personally-administered questionnaires (by the researcher), it is much less costly in terms of the researcher's time (Hakim, 1987; Sarantakos, 1998; Sekaran, 2003). Other advantages are reported as:

(a) **Low cost:** the most obvious appeal of mail questionnaire is the low cost.

Sarantakos (1998) identifies the advantages of questionnaires as cost effective. The mail questionnaire does not require a trained staff of interviewers; the processing and analysis of data are usually cost effective. Moreover, the lower cost is particularly evident when the respondents are widely distributed over a large geographic area (Sekaran, 1992).

(b) **Accessibility:** can reach a high number of respondents who live or work over a widely spread geographical area.

(c) **Greater anonymity:** it affords the respondent a reasonable degree of anonymity. Furthermore, respondents can complete the questionnaires at their-own convenience (Sekaran, 1992). Compared to face-to-face or Telephone interviewing, there is no personalization involved in a mailed questionnaire survey, and thus respondents are likely to give their true

opinion rather than an acceptable answer when faced with sensitive or controversial issues.

- (d) Reduction in bias error: the use of a mail questionnaire reduces bias errors that might result from the personal characteristics of interviews and variability in the interviewer's skills (DeVaus, 1990). This method provides less opportunity for bias or errors and provides a stable, consistent and uniform measure with wide coverage.
- (e) Collecting large amounts of information: a questionnaire enables the researcher to obtain a large amount of information from a large number of respondents within a short space of time (Babbie, 1995). This is extremely important if the fieldwork has to be completed within a restricted time period.

4.3.5.2.2 Disadvantages of the Mailed Questionnaires

The mail questionnaire does, however, have several disadvantages. The most significant are:

- (a) Requires simple questions: the method lies in the fact that it requires simple questions in the sense that the questions have to be straightforward and comprehensible solely on the basis of printed instructions and definitions.
- (b) Low response rate: the most serious problem arising from the use of a questionnaire as tool to collect data is the low response rate.
- (c) Lack of control: this method offers no control over who fills out the questionnaire.

These disadvantages, coupled with Libya's developing postal system that is as yet unreliable and slow, mean that Libyan researchers do not usually use this method.

4.3.5.3 Personally-administered Questionnaires

The personally-administered questionnaire is considered by some researchers (Collis and Hussey, 2003; Sekaran, 2003) as one of the best tools for data collection when the survey is confined to a local area, and the aim is to target a particular gathering of people at work, or at home.

4.3.5.3.1 Advantages of the Personally-administered Questionnaires

Several advantages of this approach are, according to Collis and Hussey (2003) and Sekaran (2003), as follows:

- (a) A high response rate is possible, since the researcher is able to collect responses personally and does not have to rely on a third party (the regular mail).
- (b) The potential for interviewer bias is removed.
- (c) Any confusion on the part of the respondent about the questions can be clarified on the spot by the researcher.
- (d) The researcher can introduce the research topic to the respondents by explaining the research themes, and can encourage and motivate them to respond frankly.
- (e) Administering questionnaires to large numbers of respondents at the same time is less expensive and less time-consuming than conducting interviews, even if these are held in the same location.
- (f) Less skill is required to administer a questionnaire than to conduct interviews.
- (g) The researcher has an opportunity to check the completeness of questionnaires as they are handed back.

4.3.5.3.2 Disadvantages of the Personally-administered Questionnaires

There are some disadvantages, which are:

- (a) It may be more costly than other methods, particularly, if the survey has to be conducted with participants who are geographically separated or abroad.
- (b) Respondents may be hesitant about sensitive issues.

In the present study, two types of questionnaire – personally-administered and mailed – were adopted.

4.4 Relevance of Questions to the Research Objectives

The design of any questionnaire is crucial in the potential of the instrument to gain the type of data required to answer the research questions and meet the stipulated research objectives. Hence, all the questions should be carefully formulated to elicit the information needed, and in designing the questionnaires for this study, the researcher bore in mind that:

- (1) Each item in the questionnaire should have a certain role in the study, and the point of each question should be clear in order to fulfil its purpose.
- (2) Every group of questions in each of the four scales should aim to test a certain variable.
- (3) Before including an item in the questionnaire, the decision should be made regarding how the responses to that question would be analysed, which statistical techniques would be used, and how it should be published or presented.

4.4.1 The Wording of Questions

It is always necessary to consider each and every question in a survey questionnaire in order to ensure that the responses are valid. In this respect, Sekaran (2003) suggested that the questions asked, the language used, and the actual wording, should meet the respondents' attitudes, and perceptions.

Saunders et al (2003) suggested the following guidelines for wording questionnaires:

- 1- The questions should be clear, straightforward, and use simple language and common concepts. Most importantly, questions should use familiar vocabulary and known terms.
- 2- To clearly show the possible responses to each question, a straightforward scale should be provided, from which the respondent can choose an answer.
- 3- Biased questions must be avoided. A biased question is one which makes one response more likely than another, regardless of the respondent's opinion.
- 4- The questions should be short and direct, because long questions are difficult to understand, consume the respondent's time and make the respondent less willing to participate. Indirect questions increase the probability of the question being misunderstood.
- 5- Leading questions should be avoided. A leading question is defined (Kumar 1999:120) as "one which, by its contents, structure or wording, leads a respondent to answer in a certain direction". Employing emotive language or phrasing a question in a particular way can suggest to the respondent how a question should be answered, so that the respondent's honest response is not obtained.
- 6- Ambiguous wording should be avoided, so that all respondents understand the questions in the same way.
- 7- Questionnaires should not include negative questions, because these may confuse the participants, especially when asking them to indicate whether they agree or disagree with a particular statement. Sekaran (2003) has suggested the inclusion of some negative questions.

In this study, the researcher followed these guidelines very closely in order to produce the best possible research instrument.

4.4.2 The Sequence and Flow of Questions

A questionnaire that is properly-sequenced facilitates completion, since to some extent, respondents can anticipate what questions might be following, and can sub-consciously enter a mindset that is ready for them. Sekaran (2003) recommends attention be paid to ordering the questions so that they move from the general to the particular, and from easy to progressively more difficult questions, using what he refers to as the 'funnel' approach. Hence, during the writer's construction of the questionnaire, certain principles were implemented as follows:

1. Questions on similar topics were grouped together, thereby providing a logical flow. The questionnaire was divided into two parts, the first collecting demographic information, and the second part gathering the content required to meet the research questions. The second part contained four sections.
2. Broad questions were followed by specific questions that were determined by the respondent's initial response.
3. Initial questions were constructed so that respondents had no hesitation in answering.
4. Initial questions were easy and it was emphasised that the reason for asking the questions was the researcher's interest in the respondent's views rather than a need to test their knowledge.
5. All questions were relevant to the respondents.
6. Open questions were kept to a minimum, and placed at the end of the questionnaire.

4.4.3 The Type of Questions

The decision regarding the type of questions in a survey instrument is really one that considers whether to use open or closed questions, because each has

both advantages and disadvantages (Sekaran, 2003). In this regard, it has been observed by Remenyi et al (2002) that exploratory studies are best administered using open questions because in these the researcher is neither able nor willing to pre-specify the response categories. One benefit of open questions is that they allow respondents to provide more information and to use their own words to give their personal opinions. Additionally, such questions are easy to ask. However, the disadvantages of open questions are quickly spotted in that they lengthen the whole process, as respondents spend more time answering. This has a number of repercussions: a) the extra time required of the respondents may dissuade them from taking part, b) this affects the overall response rate because some questionnaires may have so many incomplete answers that they have to be excluded from the final usable sample, c) the analysis of the responses to open questions is difficult and whilst there may be much valuable information there may also be much useless and irrelevant data (Remenyi et al, 2002; Sekaran, 2003; Collis and Hussey, 2003).

Unlike open questions, closed questions require the respondent to answer either Yes or No, or to choose a response from several alternatives provided on the questionnaire. Whilst these usually do not take the respondent long to complete, they can be difficult to design since they must be very clear and take account of all possible answers. Additionally, the use of closed questions may not provide true or accurate responses since they give a limited range of options, and as Vaus (2001) has observed, the respondent must make a choice even though it may not be appropriate. In this respect, it is noted (Denscombe, 2003) that frustration may arise among respondents because they cannot give their opinions as they would prefer (Denscombe 2003). That said, closed

questions are useful for collecting certain types of data, and their analysis is straightforward because the range of answers is limited. Furthermore, because of the speed in answering them, it is possible to ask a large number of such questions, and given the standardisation of the responses, the answers can be compared across respondents. It was decided to use closed questions in the main for the questionnaire in this study.

4.4.4 Scaling Process

According to Sekaran (2003:185) a scale is

“a tool or mechanism by which individuals are distinguished as to how they differ from one another in the variables of interest to our study. The scale or a tool could be a broad one in the sense that it would only broadly categorised individuals on certain variables, or it could be a fine-tuned tool that would differentiate individuals on the variables with varying degrees of sophistication”.

Different styles of both open and closed questions were used. The dichotomous question, offering only two fixed alternatives, was used to gather information about gender, for instance, and multiple-choice questions, providing a range of options were used in respect of age, qualifications and experience in auditing. Multiple-response questions gave respondents the opportunity to select more than one response, as for example when participants were asked to indicate who (from a list of individuals) decided what items to include in the audit quality plan of the audit firm and oil companies and where participants were asked to rank order a response, ordinal scales were used, with the evidence placed in categories, and the numbers assigned indicating the ordering of the categories (Remenyi et al, 2002).

Respondents were asked to show their level of agreement with certain statements in the main parts of the questionnaire, the agreement being recorded on Likert-type scales. The statements related to: the current perception of audit quality, firm size, the provision of NAS, the length of auditor tenure, level of competition in the audit market, fees for audit services, and future development of audit quality. Respondents were asked to tick one of five boxes on the accompanying scale which ranged from (1) strong disagreement to (5) strong agreement. This type of scale suggests that every statement has the same attitudinal value, weight or importance in order to reflect an attitude towards the issues examined by the scale (Sekaran, 2003).

4.5 The Questionnaire Design

Some of the questions in the questionnaire were derived from suggestions made by the focus group of Libyan PhD accounting students at Liverpool JMU, who had sufficient knowledge of accounting in the Libyan business environment. Some were derived from prior studies (Palmrose, 1988; Fearnley et al, 2005; Mashat, 2005; Al Mogbel, 2006; DeFond et al, 2002; Francis, 1984; Sori, 2005), and some were suggested by several internal auditors, financial managers and accounts managers. Each section of the questionnaire is now briefly described.

Section A: General Information. This section focuses mainly on eliciting demographic data about respondents (e.g. number of years of experience in the field and their qualifications), and was particularly important for providing basic data both for the purpose of analysis, and for testing relationships with other variables identified in the study.

Section B: The Current Perception of Audit Quality in Libya. This section includes questions exploring the general perceptions of audit quality in Libya. The idea behind these questions was to give respondents a flavour of the questionnaire as a whole, and to obtain their opinion on the overall level of audit quality in Libya before moving on to more detailed questions.

Section C: Factors Impairing and Enhancing Audit Quality. There are some difficulties with measuring audit quality, and this has led some researchers to use different variables as surrogates for it. Allowing for these difficulties, and bearing in mind the auditing environment in Libya, this section of the questionnaire was divided into five main sub-sections covering the most important variables which can be used as surrogates for audit quality in the Libyan environment. These surrogates are: firm size, the provision of NAS, the length of auditor tenure, competition in the audit market, and fees for audit services.

Section D: Future Development of Audit Quality in Libya. This section deals with respondents' views about the future development of audit in Libya. Opinions were sought on ways in which audit quality could be developed and enhanced in the future.

4.6 The Pilot Procedures in Respect of the Questionnaire

Remenyi et al (2002) recommended that pre-testing of any questionnaire should be conducted before finally administering the instrument, in order to identify any shortcomings in its design and administration. They suggested that the method of pre-testing could be informal, involving consultation with

friends, colleagues and experts, or it could be more formal, involving a pilot study which is a replication, on a small scale, of the main study. In line with Remenyi et al (2002), Sekaran (2003) also stressed the importance of pre-testing a survey instrument to ensure that questions are understood by the pilot sample, which should be representative of the eventual participants. In this respect, it is vital that questions do not suffer from ambiguity, and that the wording and measurements used are free from any problems that might compromise the responses. Oppenheim (1992) listed the following reasons for conducting a pilot study:

1. To test the reliability and validity of the instrument in order to avoid future problems.
2. To ensure that the instrument will be accessible to the study participants.
3. To confirm future co-operation with the participants.
4. To test the methodological techniques.

A number of procedures were employed before conducting the final survey. The first step in piloting the questionnaire involved the first draft of the questionnaire being prepared in the English language, and presenting this to the supervision team as well to the researcher's colleagues (PhD students and PhD holders), so that as wide an audience as possible could give their comments on it.

In the second stage, the questionnaire was translated into Arabic with the help of colleagues who were expert in the Arabic and English languages. The translated draft was discussed with PhD students whose native language is Arabic. The two copies, English and Arabic versions, were then sent to four

academic staff in Libyan universities. Some amendments were made to the Arabic version, and at a later stage the Arabic translation of the questionnaire was translated back into English by the same languages experts. After comparing the resulting English version of the questionnaire with the original, the researcher was satisfied with the accuracy of the translated version.

The final step in pre-testing the questionnaire was the pilot study itself. The data used for this pilot study was collected from two sources: the demand side (Libyan oil companies) and the supply side (audit firms working in Libya). For the audit firms, data was gathered from employees at all levels in the firm: managing partners, audit supervisors, and auditors.

The purpose of the pilot study was to test the study instrument, in particular, the phrasing of the questions, and their clarity, length, and layout, and the relevance of questionnaire items to the investigation of the study.

At this point, 48 questionnaires were distributed to the internal auditors, financial managers and accounts managers in eight Libyan oil companies, and to the managing partners, audit supervisors and auditors from eight audit firms working in Libya: five from Tripoli (the capital city) and three from Benghazi. Thirty-nine questionnaires (i.e. 81% of those distributed) were usable, four were not returned to the researcher, and five were incomplete. Of these 39, 21 questionnaires were from the Libyan oil companies and 18 from the audit firms. Regarding the internal auditors at companies, the researcher distributed the questionnaires to the directors of internal audit departments, who then distributed them to their staff.

The respondents were asked to report the time taken to complete the questionnaire, and only three failed to do this. The majority of the respondents reported that it took between 15-25 minutes, with an average of 20 minutes.

The following three points summarise the findings on the layout and completion of the questionnaire:

1. No respondents complained about the length of the questionnaire.
2. No respondents complained about the questionnaire's clarity and layout.
3. No respondents complained about the 5-point scale.

The SPSS computer program was then used to analyse the data from the pilot study, to test the appropriateness of the scales which were used to measure the study variables.

The choice of these statistical tests is related to firstly, the number of variables, secondly, to the type of question to be answered, and finally, to the scale of measurement (Zikmund, 2000).

4.7 Instrument Reliability and Validity

In order to conduct research which is of high quality, it is necessary to subject the research design to reliability and validity measures that will provide an assurance of the relevance of the issues being measured, and confirm that the instruments used are appropriate (Clark-Carter, 2004; Cozby, 2007). According to Punch (1998), these two constructs relate to the psychometric characteristics of an instrument, and basically seek to guarantee that the instrument is suitable for a particular purpose and will yield results that can be relied upon.

4.7.1 Validity

Validity is an important factor for any empirical research. Therefore, it is essential for any successful research to employ a valid tool. Validity is the ability of the measurement tool to assess what it is supposed to measure (Aaker et al, 1998). Frankfort-Nachmias and Nachmias (1996) define validity with a question in order to make it clear that the researcher is measuring what he/she intends to measure. Sarantakos (1998: 78) also maintains that validity is concerned with: "the ability to produce findings that are in agreement with theoretical and conceptual values".

Black (1999: 75) reported a similar approach, maintaining: "to ensure validity, any instrument must measure - what was intended". This indicates that the instrument should be logically consistent and cover systematically all aspects of the abstract concept to be investigated. The main problem with face validity is that there are no replicable procedures for evaluating the measuring tool. Hence, researchers have to rely entirely on subjective judgments (Frankfort-Nachmias and Nachmias, 1996). Validity needs reliable and valid tools for the collection of data as well as consultations with theoretical and empirical researchers. Therefore, the validity of the questionnaire in this study was obtained from different practical professionals and experienced employees who participated in the pilot study.

4.7.2 Reliability

In addition to validity, reliability is considered a most important factor. Newman and McNeil (1998: 205) defined reliability as: "the extent to which a

variable yields the same value on repeated measures". Reliability is a very important aspect in any research method. Further, it is concerned with the consistency of the results achieved on repeated situations. This is reflected when the researcher re -tested the data, using the same test in different circumstances. Researchers have adopted alternative methods with questionnaires. They look at the consistency of a person's response to an item at the same point in time and the degree of agreement between the measurements is obtained.

Researchers use the Alpha coefficient in order to confirm reliability. This technique is common in statistical research in examining reliability; coefficient Alpha ranges between zero (0) and one (1). The higher the Alpha Coefficient is, the more reliable the scale, with 0.7 as the minimum acceptable reliable figure (De Vaus, 1990). In this study, the Alpha Coefficient is used to measure reliability on the Statistical Package of Social Science (SPSS) computer software. In the present study, the questionnaire achieved a Cronbach's Alpha reliability value of 0.810.

4.8 The Sampling Unit and Questionnaire procedure

Clearly, the sampling unit must be representative of the general population in which a researcher has an interest, and for a questionnaire to produce good quality data, the respondents must comprise a proper sample from that population. According to Sekaran (2003:265) the population is "the entire group of people, events, or things of interest that the researcher wishes to investigate" and as Denscombe (2001) points out, the respondents must be chosen on the basis of their appropriateness. The sampling technique used by a

researcher, must therefore, be able to provide an appropriate sampling unit, to which the research instrument can be directed. Indeed, if this decision is not made with careful thought, the whole research process can fail, because as observed by Ahmed (1999) whilst the questions may be the right ones, if they are addressed to the wrong people, the answers will be completely misleading.

The data used for this study was collected from two sources: the demand side (Libyan oil companies) and the supply side (audit firms working in Libya).

The data for the Libyan oil companies was gathered from three different types of respondents: internal auditors, financial managers and accounts managers.

The reason for choosing these three groups of respondents, rather than other employees in the company, was the fact that the literature of auditing indicates that the external auditor usually has more contact with these groups than any others. For the audit firms, data was gathered from employees at all levels in the audit firm: managing partners, audit supervisors and auditors.

The main reasons for choosing oil companies was because of their high level of organisation and the fact that most of these companies employ staff with degrees from the United States or Britain – these two facts enabled the researcher to access the right people and obtain good answers to the research questions.

The magnitude of the activities of oil companies, and hence the magnitude of the accounting systems, represent an attraction for large numbers of qualified accountants, who hold jobs and different accounting backgrounds, a fact that allowed the researcher to have access to a large community of accountants, with varied careers.

4.9 The Response Rate

Having established (section 4.3.4) that one of the most important issues associated with questionnaire surveys is the response rate, the researcher was keen to ensure as much useful participation as possible. As Bryman (2004:98) notes, the response rate is “the percentage of a sample that does, in fact, agree to participate”, and it is well understood that failure in this regard is the main drawback to the use of questionnaire surveys (Collis and Hussey, 2003; Saunders et al, 2003). Moreover, mailed questionnaires usually produce a poorer outcome than personally-administered questionnaires. Various reasons exist for non-participation, but most commonly it is the case that people simply do not want to answer questions or be involved (Saunders et al, 2003) whilst in other cases the chosen respondents may be ineligible to provide relevant responses. Clearly, a low response rate is problematic, since as noted by Vaus (2001), the desired sample size can be severely depleted by this and bias can result.

In the case of this study, 147 questionnaires were distributed to the oil companies between February and April 2008. Of these, 52 went to Internal Auditors, 50 to Financial Managers, and 45 to Accounts Managers. Additionally, 300 questionnaires were sent to the audit firms working in Libya, 100 to Managing Partners, 100 to Audit Supervisors and 100 to Auditors. The samples from the demand side (internal auditors, financial managers and accounts managers), represent the agent of the principal, and conduct business on behalf of the principal. Hence, a monitoring mechanism is needed to assess their performance (Jensen and Meckling, 1976). Those samples from the

supply side (managing partners, audit supervisors and auditors), represent the main subjects of the issue of interest who provide certification and/or information credibility assessment to the stakeholders (Humphrey, 1997). Hasan (2000) has indicated that audit firms and their clients evaluate audit quality in different ways, and it was, therefore important to receive responses from both sections of the research population.

Considerable effort was made in order to avoid problems of non-response and to ensure the completeness of the questionnaire, which as already indicated, was designed with a majority of closed questions which are easy for respondents to answer. The questionnaire sample comprised all listed oil companies in the NOC and 100 audit firms working in Libya. According to the pilot study results, the wording of the questionnaire was simple, the instrument was of a reasonable length, and there were no complaints about clarity and layout. Most of the questionnaires were personally administered (Managing Partner - 52 questionnaires, Audit Supervisor - 52 questionnaires, Auditor - 56 questionnaires, Internal Auditor - 45 questionnaires, Financial Manager - 47 questionnaires, and Accounts Manager - 35 questionnaires), and some questionnaires were delivered personally by the researcher and returned by mail. Therefore, anonymity and other problems relating to mailed questionnaires were avoided as far as possible.

The overall response rate to the questionnaire was extremely encouraging at 64% (see Table 4.1), Remenyi (2002) suggesting that a response rate above 60% is considered to be exemplary. The response rates for Internal Auditors and Financial Managers were 86.5% and 94% respectively, higher than those

of Accounts Managers, Managing Partners, and Audit Supervisors, which were 77.7%, 52% and 52% respectively. Some were unable to complete the questionnaires, and the researcher was unable to contact respondents outside Tripoli because of poor communication facilities, included in which is the official postal system.

Table 4.1: Questionnaire Survey Response Rate

<i>Group</i>	<i>Distributed questionnaires</i>	<i>Useable questionnaires</i>	<i>Response rate</i>
Managing Partner	100	52	52
Audit Supervisor	100	52	52
Auditor	100	56	56
Internal Auditor	52	45	86.5
Financial Manager	50	47	94
Accounts Manager	45	35	77.7
Total	447	287	64

4.10 Qualitative Research Method

Unlike quantitative methods that primarily consider numerical values, qualitative approaches take words as their subject (Bryman, 2004), gathered as data in a narrative form through interviews and observations (Sekaran, 2003). This type of research is defined by Strauss and Corbin (1998), as research whose findings are not obtained through the use of statistical processes or other means of quantification. Confirming these definitions, Remenyi et al (2002:288) noted that “qualitative research is based on evidence that is not easily reduced to numbers. In some cases the evidence cannot be reduced to numbers and any attempt to so do would not be useful. In such cases statistical techniques are not sensible and hermeneutic approaches are preferable”. Hence, qualitative efforts are generally inductive, whereby specific

observations lead to general principles, in an exercise that can generate new ways of thinking about problems. Quantitative research, in contrast, is about using already-existing theories as a vehicle for exploring problems. Steckler et al (19992) note the popularity of qualitative research in management literature, asserting that this follows from its ability to answer 'how' questions. In this research project, the interview exercise process was designed to supplement and enhance the data obtained from questionnaires.

4.10.1 Interviews

It is accepted (Collis and Hussey, 2003) that both positivist and phenomenological approaches use interviews as a research instrument. Commenting on their operation, Collis and Hussey (2003:167) noted that interviews provide "a method of collecting data in which selected participants are asked questions in order to find out what they do, think or feel". However, interviews can vary in character, veering towards a more controlled approach that sits in line with positivistic thought, or a more relaxed one in which phenomenological techniques can be used. The structured interviews with closed questions is the preferred strategy with positivists, whereas, the unstructured, or semi-structured interview based on open questions and allowing for in-depth exploration, is the technique used by phenomenologists. May (1997) asserts the usefulness of interviews as a method which can yield rich data concerning participants' experiences, opinions, aspirations, attitudes and feelings. Moreover, he makes the point that they can be used to maintain and generate conversations on a wide range of topics, and Sekaran (2003) adds

to this flexibility, noting the different types of interview that can be employed according to the situation.

4.10.1.1 Semi-structured Interviews

Smith (1972:119) documented, many years ago, that the semi-structured interview is “a process in which the interviewer focuses on a limited number of questions or a limited number of points. It may range quite widely around a point, but this would be done only as a means of getting the required information on that particular point”. This type of interview is applicable in a wide range of circumstances (Bryman, 2004), and involves the researcher producing questions s/he wishes to ask in a given order, but at the same time allows for re-sequencing as an interview unfolds. The intention with semi-structured interviews is to encourage the interviewee to talk frankly, and this can often be achieved by removing some of the rigidity imposed by asking questions in a certain order. Semi-structured interviews are useful when undertaking exploratory discussions as a means to revealing ‘what’, ‘how’, and ‘why’ (Saunders et al, 2000). They have the potential to discover new things about issues that have been considered before, and they also allow variation from interview to interview in respect of how the questions are asked and covered. This does require skill on the part of the interviewer who must be able to respond to the flow and change questions to suit, but if the researcher is able to do this, much valuable input from interviewees can be gained. Further benefits of this type of interview are the interviewer’s ability to ask for

clarification of any response during the course of the interview, and the ability to record the proceedings, subject to the interviewee's consent (May, 2001).

4.10.1.2 Advantages of the interview method

The interview has several advantages and can be summarized as follows.

- 1) Interviews allow the researcher to ask several open-ended questions;
- 2) The researcher(s)-can clearly identify him/themselves, him/their status, and the purpose of the interview;
- 3) Interviews enable the interviewer to explain to each respondent how he/she came to be chosen for the sample and why it is important that he/she take part in the interview;
- 4) Interviews give the interviewer the opportunity to communicate effectively and build trust with the respondent to make him/her comfortable, to provide truthful data and to answers without any fear of adverse consequences The interviewer can modify the questions if this is thought to be necessary and
- 5) Interviews enable the interviewee the opportunity to provide the data required in-depth.

4.10.1.3 Disadvantages of the interview method

The interview method, however, has several disadvantages (Oppenheim, 1992).

- 1) Interviews incur higher costs and need more time than a mail questionnaire. The cost of an interview studies is significantly higher than that of a mail surveys, in terms of the skills needed, training, and especially when interviews are spread over a geographically large area;
- 2) The flexibility that is the chief advantage of the interview leaves room for the interviewer's personal influence and bias. In addition, respondents may bias the data when they are aware of possible adverse effects of answering Questions on sensitive issues and do not express their true perceptions but

provide information that they think is what the interviewer will be happy with;
and

3) Lack of anonymity: the interview lacks the anonymity of a mail questionnaire. The presence of the interviewer may cause the interviewee anxiety, especially if a respondent is sensitive to the topic or some of the questions.

4.11 The Sampling Unit and Interview Procedures

The sample for the interviews was broadly similar to the sample for the questionnaire, which comprised a sample from Libyan oil companies, namely, internal auditors, financial managers, accounts managers, and a sample from audit firms working in Libya, namely, managing partners, auditors and audit supervisors. Regulators working in the LAAA were also included in the sample of the interviews, partly due to the fact that, after analysing the questionnaire survey, the researcher found it necessary to interview regulators to clarify some grey areas found in the analysis, and more importantly, to triangulate the sample of the study and to obtain different opinions from different dimensions. The total number of interviews conducted with the oil companies was ten (three with internal auditors, four with financial managers, and three with accounts managers), and the total number of interviews conducted with the audit firms working in Libya, was thirteen (four with managing partners, six with audit supervisors, and three with auditors). Lastly, two interviews were conducted with regulators working for the LAAA.

As mentioned earlier in this chapter (sub-section 4.3.5.3), personal delivery and collection of questionnaires was used to help to establish contact with the targeted sample for the interview phase. Respondents to the questionnaire were

asked to provide their telephone numbers and emails if they were willing to be interviewed. Of those who did this, some were contacted to arrange an interview, after explaining to them the reason for their selection. The interviews were conducted between May and July 2008. Several interviews were undertaken to pilot the questions in the interview schedule, as a means of ensuring that the questions were clear and unambiguous, and to find out the approximate amount of time it would take to finish the list of questions. Respondents were asked both open and closed questions. Because of the tendency of open questions to lead to a long discussion, resulting in difficulty with completing the original questions, the use of these was limited to starting a new topic, and closed questions were used to confirm the questionnaire findings.

At the beginning of each interview, the researcher first introduced himself and thanked the respondent for agreeing to take part. He then gave the interviewee a one-page summary of the study, either in English or Arabic, and assured him that his identity and the information he provided would be treated as strictly confidential and that no reference would be made to him personally in any part of the thesis. The interviewer asked the participant's permission to record the interview, as a means of enabling him to recall what had been said during the interview, especially since the interviews would have to be translated into English. Those respondents who were unwilling to be recorded justified their decision on the grounds that they felt more comfortable and able to talk frankly, by knowing that there would be no evidence against them, if problems should arise later. Where this happened, the interviewer proceeded with the interview by taking notes.

The interviewer then set the mood of the encounter by asking the interviewee for some background information about himself, and after obtaining this personal detail, he proceeded with the main part of the interview by asking an open question related to audit quality in Libya. This simply asked for the participant's views on the current level of audit quality in Libya, and allowed the opportunity for free expression of thought, such that the information provided was not biased in any way. This question was followed by a series of further questions, both open and closed. At the stage when no more new responses emerged, the researcher asked the interviewee if he would like to add any points which had not been covered in the interview. Finally, the participant was thanked for his time, contribution and co-operation. Generally, all interviewees appeared relaxed and talked informally, as well as showing great interest in the subject matter. They seemed to enjoy expressing their opinions on the issues raised in the interviews.

The interviews lasted between 40 and 75 minutes each, including the introduction and explanations. As indicated earlier, at the start of each interview, participants were asked to give their permission for the interview to be recorded on tape. In order to ensure that each interviewee felt relaxed about the use of the tape recorder, it was explained that the tape recorder was being used only in order to enhance the accuracy of the recording of the interview. Nine of the interviewees were not willing to be recorded, so the researcher took notes during these interviews, and immediately afterwards, the full text was written down in Arabic from the notes. All the interviews were translated back into English.

All the questions initially scheduled were used in the interviews, but their sequence varied from one interview to another as appropriate. Additionally, the researcher invited the participants to raise any other issues not covered by the questions. To build trust and confidence between the researcher and the interviewee, the more sensitive questions were left to the end of interview, but for the purposes of consistency, the interview results were reorganised according to the sequence of questions that was set by the researcher.

Table 4.2: Interviews at the Libyan Oil Companies and Audit Firms

Interview Date	Interviewee's Position	Organisation	Number of Interviews
12-05-2008	Internal auditor	Oil company	3
28-05-2008	Accounts manager	Oil company	3
16-06-2008	Financial manager	Oil company	4
24-06-2008	Managing partner	Audit Firm (Tripoli)	4
2-07-2008	Auditor	Audit Firm (Bengasi)	3
21-07-2008	Audit supervisor	Audit Firm (Tripoli)	6
21-07-2008	Regulator	LAAA	2
TOTAL			25

4.12 Interview Analysis

The main aim of using semi-structured interviews in the study was, as mentioned earlier in this chapter (section 4.9.1.1), to understand, support and confirm the results obtained from the questionnaire exercise, and to bring insight in respect of any gaps that might have been found in the questionnaire results. The interviews were intended to address all dimensions of the questionnaire survey, and the semi-structured variant was chosen in order to

allow participants sufficient freedom to express themselves with confidence. It was hoped that the data obtained from the interviewees would be rich and detailed. However, interview data analysis can be a very difficult task, and it was necessary to plan and implement this carefully to be sure that the outcome properly reflected the information collected, which was in this case, largely descriptive.

In respect of data analysis, Miles and Huberman (1994) suggested the cross-case approach, which they further sub-divided into three possible ways forward, these being:

1. Case-oriented analysis where patterns and characteristics of individual cases or groups of cases under study are preserved throughout the analysis
2. Variable-oriented analysis where specific variables or themes are the focus of analysis across cases
3. A combination of these two approaches.

It was decided to use both case-oriented and variable-oriented analysis in an effort to overcome any weaknesses presented by just the one approach. This strategy facilitated a greater degree of generalisation than is possible with the case-oriented approach alone and also allowed for a thorough exploration and analysis of the interview data, which appears as a benefit of the case-oriented approach. Thus, it was considered that results would be generated that would fairly represent the underlying body of data gathered from interviewees.

In the data analysis, three concurrent activities were evident, as described by Miles and Huberman (1994), these being: data reduction, data display, and the drawing of conclusions. Data reduction refers to the process of selecting,

focusing, simplifying and otherwise transforming the data appearing in field notes or transcriptions. As mentioned earlier, in this study, the researcher transcribed the interviews to enable a thorough analysis. After transcription, the interview data were manually coded using the pre-identified themes, in order to reduce the data. As noted by Boyatzis (1998), the themes may be arrived at by an inductive process from the raw information, or may be generated deductively from theory and prior research. Given the fact that the interview questions were formulated in conjunction with the issues raised in the questionnaire and that these had been generated from existing theory, a deductive approach was used in which the main themes for the interview data analysis were similar to those explored in the questionnaire survey, these being: general perceptions of audit quality in Libya; audit quality variables, and means to improve audit quality in Libya. The relevant data from the coded transcripts were then entered into the appropriate matrices for data display in order to facilitate the drawing of conclusions. The matrix was useful for arranging the data from all the respondents across the various sections. A data matrix was provided for each main theme of the study, and for the emerging issues related to it. The rows of the matrix represent the variables investigated in each broad theme, and the columns represent the types of respondents.

Initially, the researcher entered the data from the coded transcripts into the relevant cells of the matrix, and labelled these according to which transcript and page of the transcript they were from, to enable tracing back to their sources if this was required. This was an important consideration for the researcher. The data in the matrix were then checked to ensure that they had been placed in the correct cell, and to keep open the possibility of further

analysis. Additionally, each transcript was re-checked to be certain that no important coded data had been omitted. As a third step, the data in the matrix were analysed to begin the process of drawing conclusions and making interpretations. In this respect, some suggestions are offered by Miles and Huberman (1994), who recommend noting patterns and contrasts, making comparisons, and clustering and counting. In the current study, contributions from the different types of participants were compared within each theme to establish whether support existed for the questionnaire survey results. It is also possible for data in matrices to be further partitioned and clustered, so that contrasts between sets of cases on variables of interest can be clarified.

4.13 Questionnaires versus Interviews

The decision to engage in both a questionnaire survey and an interview exercise was made on the assumption that both would provide insights in the business of evaluating the strength of audit quality in Libya. However, a purpose of the interviews only, was partly to approach some issues which could not be properly dealt with or analysed by quantitative methods. In this respect, officials at the Libyan Oil Companies and Audit Firms who were represented in the sample of interviewees were expected to provide information in a private meeting and explain further issues related to the significance of information contained in the current perception of audit quality in Libya and audit quality variables. However, whilst interviews are considered an effective means of collecting large amounts of data, some restrictions were encountered by the researcher when conducting interviews in the study, and these should be noted at this point. Firstly, as in Western countries, interviews are time-

consuming and therefore costly, and they can be seen as intrusive, which may reduce the participants' co-operation. There is also sometimes a problem of getting the interview transcripts translated, and there are other problems that arise particularly with Libyan interviewees. In this connection the researcher found that:

1. Most of the interviewees found it difficult to describe their problems in general, and more specifically, when they were asked about something related to their work as Internal Auditor or Financial Manager, especially if they were meeting the interviewer for the first time.
2. Most of the interviewees, especially the key staff, seemed to fear that the interview would cover information regarding their institution and that their position in their company could be threatened.
3. Permission to tape-record interviews was refused in some cases, because this is an unfamiliar experience in Libyan society and is seen by some as threatening. Additionally, some of the respondents who did give their permission to record the proceedings, were noticeably tense during the interviews.

The researcher became aware that it was not practical to hope for honest and open interviews about such sensitive issues and concluded that the exercise was less likely to provide valid information in Libya than it might in Western countries

4.14 Statistical Analyses Employed

This section considers the statistical tests employed to measure the similarities and differences among the groups of respondents in their perceptions of audit quality. Statistical analysis is popular among researchers, being used for several reasons. Kerlinger (1986) listed four different motives in this respect, these being: a) to reduce large quantities of data to a manageable and

understandable form, b) to aid in the study of population and samples, c) to assist decision-making, and d) to enable the deduction of reliable inferences.

Parametric and non-parametric tests are the two broad classifications of statistical tests, and each is more suited to particular circumstances. Parametric tests are believed to yield valid and powerful results as long as certain conditions are met. These pre-requisites are (see Siegel, 1995:19; Siegel and Castellan, 1988:20):

1. The observations must be independent of error.
2. The observations must have equal variance in the various treatment populations.
3. The observations must be drawn from normally distributed scores in the treatment of population.
4. The variables must have been measured as at least an interval scale.

However, in social science research, non-parametric tests are also as important as parametric tests, since as pointed out by Siegel and Castellan (1988:34), it is not common for behavioural scientists to obtain data that satisfy all the assumptions of the parametric test, which includes achieving the sort of measurements which permit meaningful interpretation of parametric tests. Non-parametric tests consequently adopt an important role in behavioural and social sciences research. Such tests make no assumptions about the distribution of scores or other data in the whole population as a whole (they are 'distribution-free'), and nor do they require measurement on an interval scale. Moreover, the data does not have to meet the strict assumptions of the parametric methods, such as normality and homogeneity of variance. It is clear that the use of the non-parametric techniques is more appropriate in this study, as the collected data is weaker than that of an interval scale. Moreover, the

statistical test utilised is determined by the information in the scale. According to Newbold et al (2003) non-parametric tests are techniques used to statistically analyse nominal or ordinal data, or numerical data without the assumption of population normality (i.e. distribution-free tests). Such data are usually obtained in many settings, including questionnaires surveys. Two non-parametric tests were applied in this research: the Mann-Whitney test and Kruskal-Wallis test which are discussed in sub section 4.13.1.

Bereson and Levine (1992) and Siegel and Castellan (1988) have documented a number of advantages of non-parametric tests, namely:

1. Non-parametric statistical tests are typically much easier to learn and to apply than are parametric tests.
2. Non-parametric methods may be used on all types of data.
3. Non-parametric methods are no less powerful than parametric methods when the assumptions of the latter are fulfilled, and are perhaps even more powerful in the event of violating the assumptions of parametric methods.
4. Non-parametric methods are normally simple to utilise when the sample sizes are small.
5. Non-parametric methods make fewer, less strict assumptions than the parametric approach.
6. Non-parametric methods provide the solution to the problem without testing the parameters of the population.
7. Non-parametric methods may be more economical than the parametric approach due to the fact that the researcher may increase power and yet save money, time and labour by collecting large samples of data that are more accurately measured, and by solving the problem faster.

On the other hand, the disadvantages of non-parametric testing arise if all the assumptions of parametric testing are fulfilled and the data is to be measured as

either an interval or a ratio scale. It was decided that non-parametric tests would be used in the present study to facilitate statistical analyses due to the nature of the research.

Once the questionnaire responses were coded according to the respondent group category (i.e. internal auditors, financial managers and accounts managers of oil companies, and managing partners, audit supervisors and auditors of audit firms), SPSS was applied to them, and the various statistical techniques used are reviewed in the following section.

4.14.1 Descriptive and Analytical Statistical Methods

Researchers note that in general, two types of statistical analysis are used, these being descriptive and inferential (Bereson and Levine, 1992; Pallant, 2001). Descriptive analysis is the transformation of raw data into an organised form that lends itself to easy interpretation to provide descriptive information. Usually, this technique involves the calculation of means and standard deviation, medians, frequency distributions, percentage distributions, rank, skewness, and kurtosis. Inferential analysis is the drawing of conclusions or making generalisations from the raw data, and this moves on from descriptive analysis to analyse difference and relationships. The aim of inferential analysis is to make predictions from the sample statistics about a wider population, and this is the approach that was adopted in the current study. In this case, inferential statistics were used to evaluate the perceptions of the participants, and to analyse the responses in the questionnaire by using frequencies and percentages, as well as to find out whether significant differences exist between and within respondent groups. The method of statistical inference was used in

this research to compare the responses, opinions and perceptions of the respondents according to the three respondent groups (i.e. internal auditors, financial managers and accounts managers of oil companies) and three groups of each respondent category (managing partners, audit supervisors and auditors of audit firms).

Two non-parametric tests: (1) the Kruskal-Wallis test and (2) the Mann-Whitney U-test, were used in the study, essentially because they suit the nature of the data analysis to be undertaken, as is briefly discussed below.

The Kruskal-Wallis test is a test of one-way, between-groups analysis of variance that allows a comparison of three or more groups (Pallant, 2001). This test was applied to establish the relationships among perceptions on issues relating to audit quality between the respondent groups. The Mann-Whitney U-test allows for testing differences between two independent groups when the populations are not normally distributed or when it is not possible to guarantee that samples are taken from populations of equal variability. It is an alternative to the t-test for two independent samples (Pallant, 2001; Zikmund, 2000). Whilst the t-test examines whether the means of two populations differ, the Mann-Whitney U-test is more general, looking for differences in means, variances or shape of distribution, or any combination of these (Silver, 1997). Silver (1997) argues that although the Mann-Whitney U-test is less powerful in its conclusions than the t-test, it is nonetheless more flexible in the range of circumstances where it can be used. In this study, the Mann-Whitney U-test is used to make comparisons of responses from Big Four and non-Big audit firms. This test was the most appropriate because the dependent variable is

measured on an ordinal scale and the independent variable consists of two unrelated group of samples.

4.15 Triangulation

The combination of two or more methods of data collection is advocated by researchers as valuable in allowing the process of triangulation, which essentially gives more credence to the results obtained (Bryman, 2004). This could be achieved, for example by the use of interviews, and focus groups, both of which would generate qualitative data that would complement each other. Hussey and Hussey (1997) note the benefit of collecting both quantitative and qualitative data in an attempt to triangulate findings, suggesting this to be an advantage for any research project. Considering the advantages of triangulation, Webb et al (1966) believed this to result in greater confidence in the results, and on the same theme, Saunders et al (2000) asserted that triangulation increases confidence that researchers are addressing the most important issues.

The use of quantitative and qualitative measures in this study, through the questionnaire survey and interview exercise, served as a means to triangulate the data, despite the fact that the interview exercise was found to contain several flaws. This problem in itself provided a different insight into the problem and the data, signalling the sensitivity surrounding this area of questioning.

4.16 Summary

This chapter has provided details of the methodology adopted in order to achieve the objectives of the study. It has described positivistic and phenomenological research paradigms, and considered the approach for this study, which combines quantitative and qualitative data (i.e. questionnaires and interviews). A comprehensive explanation of the questionnaire and interview procedures has also been offered, and the pilot test in respect of the questionnaire survey has been detailed. The idea of using both interviews and questionnaires, and the problems facing the researcher in conducting the interviews, has been discussed, and the reason for combining the two methods has been given. The following chapter presents the statistical findings relating to the questionnaire survey.

CHAPTER FIVE

QUANTITATIVE FINDINGS

5.1 Introduction

This chapter reports on the findings of the survey conducted in Libya during the period February to April 2008. In doing this, it analyses and summarises the questionnaire data that was collected from Libyan oil companies and audit firms working in the country.

The chapter begins with a descriptive analysis of demographic data, the purposes of which have been listed by Diamantopoulos and Schlegelmilch (1997:73) as being to:

- a) Provide preliminary insights as to the nature of the responses collected, as reflected in the distribution of the values for each variable of interest.
- b) Help in detecting errors when coding the data.
- c) Present the data in a digestible way (through the use of graphs and tables).
- d) Provide an early opportunity for checking whether the distributional assumptions of the subsequent statistical tests are likely to be satisfied.

The analysis and discussion of the findings on audit quality in Libya are presented on a section-by-section basis as indicated in the rationale for the questionnaire.

The remainder of this chapter is organised as follows: Initially, the descriptive statistics of the general information of two groups of respondents: audit firms and Libyan oil companies, are presented. The survey results pertaining to the

general perception of audit quality in Libya are then documented, after which the audit quality variables are considered. Thereafter, the future development of audit quality in Libya is discussed, and finally, a brief summary of the findings is given before the chapter is concluded.

In the following sections, responses to the questionnaire are presented in tables. Respondents were asked to indicate their level of agreement with a number of questions on a scale ranging from 1 to 5, where (1) represented strongly disagree, (2) disagree, (3) no view, (4) agree and (5) strongly agree. The means reported in each table are calculated on this scale but tests for significant differences between respondents using the Kruskal-Wallis and the Mann-Whitney tests are based on the full 5-point distribution of responses.

5.2 Analysis of Section A of the Questionnaire: General Information

Table 5.1: The Gender of Respondents

Gender	Frequency	Percentage
Male	236	82.2
Female	51	17.8
Total	287	100

Table 5.1 depicts the basic descriptive statistics of the participants, revealing that 82.2% of the participants are males while just 17.8% are females. This reflects that most workers in the audit field are males, a feature which is explained by the fact that there is no balance between the qualified females and qualified males in this field. Moreover, males are more educated than females.

Table 5.2: The Age of Respondents

Age	Frequency	Percentage
20 – 29 Years	45	15.7
30 – 39 Years	87	30.3
40 – 49 Years	112	39.0
Over 50 Years	43	15.0
Total	287	100

Table 5.2 demonstrates that 15.7% of those surveyed are between 20-29 years, 30.3% of respondents are between 30-39, 39% of respondents are between 40-49, with the remaining respondents (15%) being aged 50 years and over.

Table 5.3: The Position of Respondents

	Position	Frequency	Percentage
Audit Firms Staff	Managing Partner	52	32.5
	Audit Supervisor	52	32.5
	Auditor	56	35
	Total	160	100
Oil Companies Staff	Internal Auditor	45	35.4
	Financial Manager	47	37
	Accounts Manager	35	27.6
	Total	127	100
Total		287	100

Table 5.3 shows the frequencies and percentages of the positions of respondents, and consists of two parts. The first part is the frequency distribution of the audit firm positions while the second part displays the frequency distribution of the companies' staff. In the first part, Table 5.3 shows that 32.5% of the respondents are audit supervisors, another 32.5% managing partners, and the remaining 35% being auditors. In the second part, the internal auditor and financial manager are seen as being represented in the proportions of 35.4%, and 37% respectively, while accounts managers number 27.6%.

Table 5.4: The Experience Levels of Respondents

Experience	Frequency	Percentage
Less than 5 Years	34	11.8
5 – 10 Years	59	20.6
More Than 10 Years	194	67.6
Total	287	100

Table 5.4 depicts the frequency distribution of the experience levels of respondents. An increasing distribution was found, indicating a high percentage of respondents to have a high level of experience, a fact that should improve the quality of responses

Table 5.5: Academic Qualifications of Respondents

Academic qualification	Frequency	Percentage
First University degree	180	62.7
Higher Diploma	28	9.8
Master Degree	47	16.4
PhD Degree	32	11.1
Total	287	100

Table 5.5 shows the highest academic qualification held by respondents. From this it can be seen that within Libyan oil companies and audit firms, 62.7% of respondents hold a first university degree while 9.8% of the respondents hold a postgraduate diploma. However, 16.4% of respondents hold a Master's degree and 11.1% a PhD.

Table 5.6: The Professional Qualifications of Respondents

Professional Qualification	Frequency	Percentage
None	112	39.0
ICAEW	24	8.4
AICPA	19	6.6
ASCA	10	3.5
LAAA	122	42.5
Total	287	100

Table 5.6 shows the frequency distribution of the professional qualification of respondents. A high percentage of respondents (42.5%) have the LAAA certificate, the second highest percentage of respondents, 39%, have no certificate and just 6.6 %, and 3.5% have the AICPA and ASCA respectively.

Table 5.7: Types of Audit Firm

Status	Audit Firm	
	Frequency	Percentage
Local Audit firm	96	60
Local Affiliated to an Arab and International Audit firm	43	27
Local Affiliated to one of the Big Four Audit firms	21	13
Total	160	100

Table 5.7 shows the frequency distribution of the status of the external audit firm of respondents, from which it is seen that 60% of the audit firm respondents had worked for local audit firms, 27% had worked for one of the firms affiliated to Arab and International audit firms, and 13% had worked for a local firm affiliated to one of the Big Four audit firms. Therefore, due to differences in audit firm type in the sample, and, more importantly, to facilitate statistical analysis, audit firm types were categorised as non-Big Four audit firms and Big Four audit firms.

Table 5.8: Percentage of Respondents who Received or Provided Non-Audit Services

Status	Audit Firm Staff		Oil Company Staff	
	Frequency	Percentage	Frequency	Percentage
Yes	120	75	76	59.8
No	40	25	51	40.2
Total	160	100	127	100

Table 5.8 depicts the percentage of Non-Audit Services (NAS) provided or received by the audit client(s) by both audit firm and oil company staff, and shows that 40.2% of oil company respondents had not received any type of NAS from their external auditor, whereas 59.8% had. In contrast, the majority of audit firm respondents (75%) reported that they had provided NAS to their audit clients, but 25% claimed not to have provided any such service. The very large percentage of audit firms that did provide NAS may be explained by the fact that an audit firm may audit different types of companies.

5.3 Analysis of Section B of the Questionnaire

5.3.1 The Current Perception of Audit Quality in Libya

As shown in Table 5.9, an analysis of respondents by oil company and audit firm reveals that 68.5% of oil company respondents either agreed or strongly agreed with the statement that *The current level of audit quality in Libya is insufficient* (mean values of 3.87). In respect of audit firm respondents, this percentage was 56.3% (a mean value of 3.46). This could be due to several reasons: firstly, the perceived lack of professionalism among auditors in Libya, since 51.9% and 43.8% of respondents (oil companies and audit firms respectively) either agreed or strongly agreed with the statement that *The lack of the professionalism of auditors in Libya causes the low level of audit quality* (mean values of 3.31 and 3.21). Secondly, the LAAA is seen to have

contributed nothing as indicated by the fact that 66.1% and 64.4% of respondents from the oil companies and audit firms either disagreed or strongly disagreed with the statement that *The Libyan Accountants and Auditors Association (LAAA) plays an important role in developing the profession of auditing and enhancing audit quality* (a mean value of 2.35 and 2.49). This finding is consistent with Mousa (2005) who suggested are the small size and limited authority of the LAAA.

Thirdly, respondents from both the oil companies and audit firms (59% and 61.3% respectively) believed that the *Rules and regulations in Libyan are not comprehensive provisions that lack and cause low level audit quality* (mean values of 3.55 and 3.61).

Overall perceptions of respondents from both groups can be seen as 66.9% and 59.4% in terms of either agreeing or strongly agreeing with the statement that *Most oil companies in Libya prefer audit firms that are affiliated to foreign audit firms and audit quality depends on the status of the audit firm e.g. local affiliated to a foreign audit firm* (mean value of 4.00 and 3.46). This result may be due to several reasons: firstly, the international audit firms tend to exercise a higher level of professionalism to protect their reputations. Secondly, local audit firms affiliated to a foreign audit firm are larger in terms of size and, therefore, obtain more exposure from the type of clients they have audited. Additionally, they may be subject to more control from their foreign affiliated firms.

Table 5.9: Distribution of Evaluations of Different Statements Regarding the Current Perception of Audit Quality in Libya

Statement	Audit Firms										Oil Companies									
	SD %	D %	NV %	A %	SA %	Mean	Median	SD %	D %	NV %	A %	SA %	Mean	Median	Sig					
Rules and regulations in Libyan are not comprehensive provisions that lack and cause low audit quality.	3.1	8.1	27.5	46.9	14.4	3.61	4.00	5.5	8.7	26.8	43.3	15.7	3.55	4.00						
The current level of audit quality in Libya is insufficient	13.1	11.3	19.4	28.8	27.5	3.46	4.00	9.4	13.4	8.7	18.1	50.4	3.87	5.00	*					
The Libyan Accountants and Auditors Association (LAAA) plays an important role in developing the profession of auditing and enhances audit quality.	17.5	46.9	13.1	14.4	8.1	2.49	2.00	18.9	47.2	21.3	4.7	7.9	2.35	2.00						
The accounting and auditing curricula in the Libyan education system are insufficient to train auditors.	3.1	11.9	19.4	38.8	26.9	3.74	4.00	11	5.5	11.8	38.6	33.1	3.77	4.00						
The lack of professionalism of auditors in Libya causes the low level of audit quality	6.9	30.6	18.8	22.5	21.3	3.21	3.00	5.5	20.5	22	40.9	11	3.31	4.00						
Most oil companies in Libya prefer audit firms that are affiliated to a foreign audit firm and audit quality depends on the status of the audit firm e.g. local affiliated to a foreign audit firm	7.5	15	18.1	43.1	16.3	3.46	4.00	3.1	10.2	19.7	17.3	49.6	4.00	4.00	*					
Most audit firms in Libya have little idea about new audit services, such as assurance services and internet reporting.	5.6	26.3	11.3	26.9	30	3.49	4.00	18.9	3.1	15.7	51.2	11	3.32	4.00						

* ** indicates distribution of responses is significantly different at the 1%, 5% levels, respectively using the Mann Whitney U test

Another interesting finding is that just over half of the respondents (62.2% and 56.9% in oil companies and audit firms respectively) either agreed or strongly agreed with the statement that *Most audit firms in Libya have little idea about new services, such as assurance services and Internet reporting* (mean values of 3.32 and 3.49), and 71.7% and 65.7% either agreed or strongly agreed with the statement that *The accounting and auditing curricula in the Libyan education system are insufficient to train auditors* (mean values of 3.77 and 3.74). This finding is consistent with those of Mautz and Sharaf (1961:159) who stated that “*all auditors are first accountants, or at least trained as accountants, because one cannot effectively verify accounting data unless he has some knowledge of how they were gathered; summarized, and classified, and presented. He must know the procedures and practices of accounting and be familiar with its devices and techniques. Thus accounting provides a necessary background for the study of auditing.*”

From the above analysis, it is clear that responses from oil companies and audit firms are not homogeneous; therefore, an attempt is made to isolate the determinants of responses.

Two significant differences at the 1% level were found, as measured by the Mann Whitney U test. It was found that although 68.5% of oil company and 56.3% of audit firm respondents agreed with the statement that *The current level of audit quality in Libya is insufficient*, the overall responses were significant at the 1% level (Mann Whitney U test). This result might reflect the fact that the oil companies appear to be aware of insufficiencies and inadequacies in the Libyan auditing environment and are unhappy with the situation. This supports the findings in the descriptive analysis (see Table 5.9).

Moreover, both oil companies and audit firms show a level of agreement with the statement *Most oil companies in Libya prefer audit firms that are affiliated to a foreign audit firm and audit quality depends on the status of the audit firm e.g. local affiliated to a foreign audit firm* was significantly higher at the 1% level of significance in respect of the oil company respondents (66.9% either agreeing or strongly agreeing) than the audit firm respondents (59.4% either agreeing or strongly agreeing). This mismatch in the responses of the two research populations is unsurprising, as companies engaging foreign audit firms are likely to support such a statement.

5.3.1.1 The Current Perceptions of Audit Quality Based on Position

Table 5.10 shows the overall perceptions of respondents from oil company staff and audit firm staff with one significant difference in the distribution of responses at the 5% level of significance, and two significant differences at the 1% level as measured by the Kruskal-Wallis test. Financial managers and account managers had a significantly highest mean score (4.00, and 4.04) and audit supervisors, auditors and managing partners had the lowest mean scores (3.33; 3.38 and 3.67) for the statement *Most oil companies in Libya prefer audit firms that are affiliated to foreign audit firms and audit quality depends on the status of the audit firm e.g. local affiliated to a foreign audit firm*. Basically, because the Foreign Investments Regulations in Libya Law No 116 allows only Libyans to open audit offices, all foreign audit firms in the country, whether Arab, International or one of the Big Four, must be affiliated to a local audit firm. Therefore, not surprisingly, audit supervisors and managing partners, as Libyan owners would not support this statement, since it apparently favours foreign

audit firms over local audit firms, taking into account that in a Libyan context, all other staff of audit firms are not usually Libyan nationals.

Further, with regard to the statement *Most audit firms in Libya have little idea about new audit services, such as assurance services and internet reporting*, the accounts managers had a significantly higher mean score (4.14) and audit supervisors had a lower mean score (2.90). Again, this is a result that does not come as a surprise, since audit supervisors are not likely to support the statement, given that it criticises local audit firms. This finding may be interpreted in two ways: either the majority of audit clients in Libya are still audited using traditional methods, or the type of sample (oil companies) is ignorant about new services, such as assurance services and internet reporting. The literature is confirmed by this outcome, since scholars report that foreign audit firms perform more powerful and effective tests than local audit firms because of their experience and knowledge, and hence, produce higher audit quality (Dopuch and Simunic, 1980).

Table 5.10 shows only one significant difference in the distribution of responses for the statement *The current level of audit quality in Libya is insufficient* at the 5% level of significance, as measured by the Kruskal-Wallis test. Accounts managers and financial managers had a significantly high mean score (4.00 and 3.94) and auditors and audit supervisors had a lower mean score (3.25 and 3.52). This result may reflect the situation that financial and accounts managers are more unhappy with the level of audit quality than auditors and audit supervisors believe.

Table 5.10: Distribution of Different Statements Regarding the Current Perception of Audit Quality Based on Position

Statement	Audit Firm Staff						Oil Company Staff						Sig
	Managing Partner		Audit Supervisor		Auditor		Internal Auditor		Financial Manager		Accounts Manager		
	Mean	Median	Mean	Median	Mean	Median	Mean	Median	Mean	Median	Mean	Median	
Rules and regulations in Libyan are not comprehensive provisions that lack and cause low audit quality.	3.71	4.00	3.65	4.00	3.48	4.00	3.38	4.00	3.49	4.00	3.86	4.00	
The current level of audit quality in Libya is insufficient	3.63	4.00	3.52	4.00	3.25	3.00	3.69	4.00	3.94	4.00	4.00	5.00	**
The Libyan Accountants and Auditors Association (LAAA) plays an important role in developing the profession of auditing and enhances audit quality.	2.42	2.00	2.40	2.00	2.63	2.00	2.38	2.00	2.47	2.00	2.17	2.00	
The accounting and auditing curricula in the Libyan education system are sufficient to train auditors.	3.77	4.00	3.65	4.00	3.80	4.00	3.62	4.00	3.66	4.00	4.11	4.00	
The lack of professionalism of auditors in Libya causes the low level of audit quality	3.42	4.00	2.98	2.50	3.21	3.00	3.22	3.00	3.26	4.00	3.51	4.00	
Most oil companies in Libya prefer audit firms that are affiliated to foreign audit firm and audit quality depends on the status of the audit firm e.g. local affiliated to a foreign audit firm	3.67	4.00	3.33	4.00	3.38	4.00	3.96	5.00	4.04	4.00	4.00	4.00	*
Most audit firms in Libya have little idea about new audit services. Such as assurance services and internet reporting.	3.67	4.00	2.90	2.90	3.88	5.00	3.02	4.00	3.00	5.00	4.14	4.00	*

* , ** indicates distribution of responses is significantly different at the 1%, 5% levels, respectively using the Kruskal-Wallis test

5.3.1.2 The Current Perceptions of Audit Quality Based on Type of Audit Firm

The analysis of current perceptions of audit quality by type of audit firm (Table 5.11) shows one significant difference using the Kruskal-Wallis test to determine significant differences in the distribution of responses at the 5% level of significance between local audit firms, local firms affiliated to an Arab and/or International firm, and local firms affiliated to one of the Big Four audit firms (non-Big Four and Big Four). The result was found to be statistically significant at 5%. The level of agreement with the statement *Most oil companies in Libya prefer audit firms that are affiliated to foreign audit firms and audit quality depends on the status of the audit firm e.g. local affiliated to a foreign audit firm* was significantly lower from local, Arab and international audit firm (non-Big Four audit firm) respondents than from Big Four audit firm respondents. This result may be due to the fact that the Big Four are generally perceived as more professional than the non-Big Four in the auditing environment and have their own quality standards. This is not surprising, since this statement describes foreign audit firms more favourably than local audit firms.

Table 5.11: Distribution of Different Statements Regarding the Current Perception of Audit Quality Based on Type of Audit Firm

Statement	Local Audit Firm		International Audit Firm		Big Four Audit Firm		Sig
	Mean	Median	Mean	Median	Mean	Median	
Rules and regulations in Libyan are not comprehensive provisions that lack and cause low audit quality.	3.63	4.00	3.47	4.00	3.86	4.00	
The current level of audit quality in Libya is insufficient	3.41	4.00	3.58	4.00	3.48	3.00	
The Libyan Accountants and Auditors Association (LAAA) plays an important role in developing the profession of auditing and enhances audit quality.	2.45	2.00	2.51	2.00	2.62	2.00	
The accounting and auditing curricula in the Libyan education system are insufficient to train auditors.	3.68	4.00	3.74	4.00	4.05	4.00	
The lack of professionalism of auditors in Libya causes the low level of audit quality	3.32	3.00	3.05	3.00	3.00	3.00	
Most oil companies in Libya prefer audit firms that are affiliated to foreign audit firms and audit quality depends on the status of the audit firm e.g. local affiliated to a foreign audit firm	3.21	3.00	3.45	4.00	4.00	4.00	**
Most audit firms in Libya have little idea about new audit services, such as assurance services and internet reporting.	3.47	4.00	3.37	4.00	3.86	4.00	

*, ** indicates distribution of responses is significantly different at the 1%, 5% levels, respectively using the Kruskal-Wallis test

5.4 Analysis of Section C of the Questionnaire: Factors Impairing and Enhancing Audit Quality

5.4.1 Size of the Audit Firm

In order to elicit their perceptions of the relationship between audit firm size and audit quality, respondents from oil companies and audit firms were asked to indicate on a scale ranging from 1, strongly disagree, to 5, strongly agree, their disagreement or agreement with the five statements given in Table 5.12.

The statement *The Big Four firms are more risk averse in respect of damage to their reputation from public scandals and/or audit failures* had the highest mean score (3.93), resulting from 70.1% of oil company respondents agreeing or strongly agreeing with it. The statement *The local audit firms achieve a lower level of audit quality* had the second highest mean score (3.91) with as many as 71.6% of oil company respondents agreeing or strongly agreeing with it.

The statement *The companies audited by the Big Four firms are more attractive to investors and creditors* had the third highest mean score (3.77) based on the responses from oil company participants. As many as 63.8% either agreed or strongly agreed with this statement. The statement *The Big Four Firms achieve a high level of audit quality* had the fourth highest mean score (3.75), with 70.9% of respondents agreeing or strongly agreeing with it. The statements *The Big Four firms perform more powerful, effective tests and are more credible than others* and *The size of the audit firm is positively associated with audit quality* had the fifth highest mean scores (3.65 and 3.63), with 69.3% and 64.6% of respondents agreeing or strongly agreeing with them, respectively.

As many as 66.1% and 63.8% of respondents either agreed or strongly agreed with the statements *The Big Four firms can plan the audit process more effectively and can obtain a greater variety of clients* and *The Big Four firms are more independent and more likely to issue qualified reports*. These statements achieved nearly the same mean scores (3.58 and 3.57). The Statement *The Big Four firms can report the real financial situation of the clients more readily than other firms* had the lowest mean score (3.49).

In the responses from audit firm representatives, the statement *The local audit firms achieve a lower level of audit quality* had the highest mean score (3.96), with 70.7% of audit firm respondents supporting it. The statements that *The size of the audit firm is positively associated with audit quality*, *The Big Four firms achieve a high level of audit quality* and *The companies audited by the Big Four firms are more attractive to investors and creditors* had the second highest and same mean score (3.78), with as many as (66.9%, 63.8% and 68.1%) of respondents either agreeing or strongly agreeing with them, respectively. The statement that *The Big Four firms perform more powerful, effective tests and are more credible than others* had the third highest mean score (3.71), 61.9% of respondents either agreeing or strongly agreeing with it. The statement that *The Big Four firms are more risk averse in respect of damage to their reputation from public scandals and/or audit failures* had the fourth highest mean score (3.70), 63.2% of respondents either agreeing or strongly agreeing with it. The statement that *The Big Four firms can plan the audit process more effectively and can obtain a greater variety of clients* had the fifth highest mean score (3.66) with as many as 62.8% of respondents either agreeing or strongly agreeing with it.

The Statement that *The Big Four firms can report the real financial situation of the clients more readily than other firms* had the second lowest mean score (3.61) with as many as 57.8% of respondents either agreeing or strongly agreeing with it.

The Statement that *The Big Four firms are more independent and more likely to issue qualified reports* had the lowest mean score (3.11) with 48.8% of respondents either agreeing or strongly agreeing with it.

Once again, because the overall responses of oil company and audit firm respondents were not completely homogeneous, an attempt was made to isolate the determinants of responses.

The analysis of differences between oil companies' and audit firms' responses is reported in Table 5.12, which reveals one significant difference at the 1% level and one at the 5%, as measured by the Mann Whitney U test.

An inspection of each sample group's distribution of responses (which is reflected in the mean scores) shows a significant difference at the 1% level of significance between oil company and audit firm respondents for one of the nine statements, and a significant difference at the 5% level for another one of the nine statements, using the Mann Whitney U test. These findings suggest that oil company respondents perceived the Big Four as producing a higher level of audit quality than non-Big Four audit firms, the Big Four firms are more risk averse in respect of damage to their reputation from public scandals and/or audit failures, and that the Big Four firms are more independent and more likely to issue qualified reports, which is consistent with the findings of Michael (2007) who determined that clients audited by large audit firms tend to have lower unusual accruals, and are more likely to meet the benchmark

earnings targets of small earnings increases. He also found that large audit firms are more likely to issue going-concern reports. These results show that there is a significant variation in audit quality across different sizes of auditor practice offices, with larger offices providing higher quality audits. They are consistent with the conclusions drawn by Beatty (1989) and Titman and Trueman (1986) that since large audit firms (Big Four) have greater resources and possess identical technological capabilities, they are capable of performing more powerful tests. As a result, larger audit firms are more likely to be associated with more precise information than smaller audit firms.

Table 5.12: Distribution of the Evaluations given by the Different Statements Regarding the Size of Audit Firm and Audit Quality

Statement	Audit Firms							Oil Companies							Sig
	SD %	D %	NV %	A %	SA %	Mean	Median	SD %	D %	NV %	A %	SA %	Mean	Median	
The size of the audit firm is positively associated with audit quality.	5.6	7.5	20	37.5	29.4	3.78	4.00	10.2	13.4	11.8	32.3	32.3	3.63	4.00	
The Big Four firms can report the real financial situation of the clients more readily than other firms.	6.3	10.6	25.6	30.6	26.9	3.61	4.00	10.2	12.6	22.8	26.8	27.6	3.49	4.00	
The Big Four firms are more risk averse in respect of damage to their reputation from public scandals and/or audit failures.	2.5	11.9	22.5	39.4	23.8	3.70	4.00	3.1	9.4	17.3	31.5	38.6	3.93	4.00	***
The Big Four firms perform more powerful, effective tests and are more credible than others	8.1	10	20	26.3	35.6	3.71	4.00	15	11.8	3.9	32.3	37	3.65	4.00	
The Big Four Firms achieve a high level of audit quality	5.6	11.3	19.4	27.5	36.3	3.78	4.00	10.2	7.9	11	38.6	32.3	3.75	4.00	
The local audit firms achieve a lower level of audit quality	3.8	6.9	18.8	31.3	39.4	3.96	4.00	3.9	9.4	15	35.4	36.2	3.91	4.00	
The companies audited by the Big firms are more attractive to investors and creditors.	6.3	8.1	17.5	38.1	30	3.78	4.00	3.9	7.9	26	33.1	30.7	3.77	4.00	
The Big Four firms can plan the audit process more effectively and can obtain a greater variety of clients.	5.6	13.8	18.1	33.8	28.8	3.66	4.00	7.9	11	21	34.6	25.2	3.58	4.00	
The Big Four firms are more independent and more likely to issue qualified reports	18.1	15.2	21.3	27.5	17.5	3.11	3.00	9.4	11	18.9	34.6	26	3.57	4.00	*

*, ** indicates distribution of responses is significantly different at the 1%, 5% levels, respectively using the Mann Whitney U test

5.4.1.1 The Perceptions of Size of Audit Firm Based on Position:

Table 5.13 presents the analysis by position. Distributions of the responses from oil company staff and audit firm staff were significantly different at the 1% and 5% level, as measured by the Kruskal-Wallis statistic.

Overall perceptions of respondents showed one significant difference in the distribution of responses at the 1% level of significance as measured by the Kruskal Wallis test. Auditors had a significantly lower mean score (2.50) and accounts managers and financial managers had the highest mean score (4.26 and 3.49) for the statement *The Big Four firms are more independent and more likely to issue qualified reports*. This difference in the responses perhaps indicates that the oil company respondents believe large firms are wealthier than small firms and would potentially be required to give in to larger claims in the event that they were to be sued. Hence, they might be more concerned about maintaining audit quality and their reputation in the audit market than smaller firms. The result might also explain why the Big Four have been reported as providing higher quality auditing and being more independent than non-Big Four firms in the literature (Michael, 2007; Becker et al, 1998; Francis et al, 1999; Francis and Krishnan, 1999; Teoh and Wong, 1993).

Table 5.13: Distribution of Different Statements Regarding the Size of Audit Firm Based on Position

Statement	Audit Firm Staff						Oil Company Staff						Sig
	Managing Partner		Audit Supervisor		Auditor		Internal Auditor		Financial Manager		Accounts Manager		
	Mean	Median	Mean	Median	Mean	Median	Mean	Median	Mean	Median	Mean	Median	
The size of the audit firm is positively associated with audit quality.	3.88	4.00	3.62	4.00	3.82	4.00	3.58	4.00	3.64	4.00	3.69	4.00	
The Big Four firms can report the real financial situation of the clients more readily than other firms.	3.67	4.00	3.44	4.00	3.71	4.00	3.58	4.00	3.30	3.00	3.63	4.00	
The Big Four firms are more risk averse in respect of damage to their reputation from public scandals and/or audit failures.	3.90	4.00	3.67	4.00	3.45	4.00	3.91	4.00	3.77	4.00	4.17	4.00	
The Big Four firms perform more powerful, effective tests and are more credible than others	3.63	4.00	4.10	4.00	3.43	3.00	3.42	3.00	3.62	4.00	3.97	4.00	
The Big Four Firms achieve a high level of audit quality.	3.92	4.00	3.71	4.00	3.70	4.00	3.84	4.00	3.51	4.00	3.94	4.00	
The local audit firms achieve a lower level of audit quality.	4.08	4.00	3.63	4.00	4.14	4.00	3.73	3.00	3.83	4.00	4.23	3.00	
The companies audited by the Big firms are more attractive to investors and creditors.	3.73	4.00	3.65	4.00	3.93	4.00	3.62	4.00	3.91	4.00	3.77	4.00	
The Big Four firms can plan the audit process more effectively and can obtain a greater variety of clients.	3.58	4.00	3.62	4.00	3.79	4.00	3.78	4.00	3.53	4.00	3.40	3.00	
The Big Four firms are more independent and more likely to issue qualified reports	3.40	4.00	3.42	4.00	2.54	2.50	3.11	3.00	3.49	4.00	4.26	4.00	*

*,** indicates distribution of responses is significantly different at the 1%, 5% levels, respectively using the Kruskal-Wallis test

5.4.1.2 The Perceptions of Size of Audit Firm Based on Type of Audit Firm

The analysis by type of audit firm, as reported in Table 5.14, shows five significant differences between local audit firms, Arab or international firms, and local firms affiliated to one of the Big Four audit firms (non-Big Four and Big Four) at the 1% and 5% levels of significance, respectively, as measured by the Kruskal-Wallis test.

The level of agreement with the statements *The companies audited by the Big firms are more attractive to investors and creditors* and *The Big Four firms are more independent and more likely to issue qualified reports* at the level 1% of significance was significantly higher for Big Four respondents (4.33 and 3.86, mean score, respectively) than for local, Arab, and international audit firm (non-Big Four) respondents (3.83, 2.90 and 3.37, 3.21, respectively). This outcome is consistent with the study conducted by Michael (2007) who found that clients audited by large audit firms tend to have lower unusual accruals, and are more likely to meet the benchmark earnings targets of small earnings increases. Jang and Lin (1993) found that trading volume on the first trading day was significantly larger for firms audited by the Big Eight audit firms than for firms audited by non-Big Eight audit firms.

In addition, the analysis by type of audit firm in Table 5.14 shows three significant differences between local audit firms, local firms affiliated to an Arab or international audit firm, and local firms affiliated to one of the Big Four audit firms, (non-Big Four and Big Four) at the 5% level of significance, as measured by the Kruskal-Wallis test. The level of agreement with these three statements by Big Four audit firm respondents was significantly higher than it was by non-Big Four audit firm respondents. This disagreement in the responses from the Big Four audit firm respondents perhaps indicates the main reasons why, in their view, the Big Four are

perceived as producing a higher level of audit quality than the non-Big Four. The reasons may be summarised as follows:

- 1- The Big Four firms are more independent and more likely to issue qualified reports.
- 2- The Big Four firms can report the real financial situation of the clients more readily than other firms.
- 3- The Big Four firms perform more powerful, effective tests and are more credible than others.
- 4- The Big Four firms can plan the audit process more effectively and can obtain a greater variety of clients.

It is worth mentioning here that these results strongly support previous studies, such as the one undertaken by De Angelo (1981a) who argued that audit quality is directly related to the size of auditing firm, that conducted by Dopuch and Simunic (1980) who reported that the Big Four are perceived as providing a higher level of audit quality than non-Big Four auditors because they are viewed as being more credible and have more resources, and the research by Morris and Strawser (1999) that found that banks receiving modified audit reports from Big Six audit firms were more likely to continue, and not be closed by the regulators than those receiving modified audit reports from non-Big Six audit firms. In contrast, banks receiving non-modified audit reports from non-Big Six (as the Big Four were then) audit firms were more likely to be closed than those receiving non-modified audit reports from Big Six audit firms. Overall, respondents' perceptions of the relationship between firm size and level of audit quality are consistent with the notion that higher audit quality is associated with the Big Four audit firms.

Table 5.14: Distribution of Different Statements Regarding the Size of Audit Firm Based on Type of Audit Firm

Statement	Local Audit Firm		International Audit Firm		Big Four Audit Firm		Sig
	Mean	Median	Mean	Median	Mean	Median	
The size of the audit firm is positively associated with audit quality.	3.71	4.00	3.72	4.00	4.19	5.00	
The Big Four firms can report the real financial situation of the clients more readily than other firms.	3.67	4.00	3.35	4.00	3.90	4.00	
The Big Four firms are more risk averse in respect of damage to their reputation from public scandals and/or audit failures.	3.71	4.00	3.44	4.00	4.19	4.00	**
The Big Four firms perform more powerful, effective tests and are more credible than others.	3.73	4.00	3.42	4.00	4.24	5.00	**
The Big Four Firms achieve a high level of audit quality	3.79	4.00	3.44	4.00	4.38	5.00	**
The local audit firms achieve a lower level of audit quality	3.89	4.00	4.00	4.00	4.19	4.00	
The companies audited by the Big firms are more attractive to investors and creditors.	3.83	4.00	3.37	4.00	4.33	4.00	*
The Big Four firms can plan the audit process more effectively and can obtain a greater variety of clients.	3.71	4.00	3.58	4.00	3.62	4.00	
The Big Four firms are more independent and more likely to issue qualified reports	2.90	3.00	3.21	3.00	3.86	4.00	*

* ** indicates distribution of responses is significantly different at the 1%, 5% levels, respectively using the Kruskal-Wallis test

5.4.2 The Provision of NAS

Table 5.15 presents the analysis of respondents' perceptions about the relationship between the provision of NAS and audit quality. It shows that 84.2% of oil company respondents either agreed or strongly agreed with the statement *The provision of NAS to an audit client gives the auditor more experience of the client's industry and more access to the client's accounting system*. This statement achieved the highest mean score (4.24). *Providing NAS to an audit client by a separate department gives the auditor more credibility* had the highest second mean score (3.50), with (60.7%) of oil company respondents either agreeing or strongly agreeing with it. This result might reflect the respondents' confidence in the safeguards of auditor independence from the segregation of duties by splitting the provision of audit and NAS into separate departments, which is consistent with the arguments proposed by Canning and Gwilliam (1999) and Pany and Reckers (1984).

Sequentially, the third highest mean score (3.39) was achieved by the statement *The prohibition of the provision of NAS to an audit client is only to maintain the perception of independence*. Again, 48% either agreed or strongly agreed with it. The statement with the fourth highest mean score (3.20) was *The provision of NAS to an audit client reduces the probability of switch threat change auditor*, with half (50.4%) of respondents either agreeing or strongly agreeing with it.

In contrast, a third of the oil company respondents (33.1%) either agreed or strongly agreed with the statement *The provision of NAS to an audit client leads to economic dependency on that client and causes a conflict of interests for the auditor*. It achieved the lowest mean score of (2.50). The statement with the second lowest mean score

2.83) was *The provision of NAS impairs audit quality*, with which 23.7% of respondents either agreed or strongly agreed.

The statement with the third lowest mean score (3.04) was *Only a certain type of NAS impairs audit quality*. Over a third (45.7%) of respondents either agreed or strongly agreed with this statement.

With regard to responses from the audit firms, Table 5.15 shows that the statement *The provision of NAS to an audit client gives the auditor more experience of the client's industry and more access to the client's accounting system*, achieved the highest mean score of 3.98, with 72.5% of respondents either agreeing or strongly agreeing.

The statement with the next highest mean score (3.58) was *The prohibition of the provision of NAS to an audit client is only to maintain the perception of independence*, which gained either agreement or strong agreement from 58.8% of respondents. The statement *The provision of NAS to an audit client reduces the probability of a threat to switch auditor* achieved a mean value of (3.53), with just over half (51.9%) of respondents either agreeing or strongly agreeing with it. The statement with the fourth highest mean score (3.34) was *Providing NAS to an audit client by a separate department gives the auditor more credibility*. Just under half (47.5%) of respondents either agreed or strongly agreed with this statement, possibly reflecting the confidence of the respondents from large audit firms and local firms in their ability to separate their staff according to the type of services they were commissioned to perform. Indeed, the provision of NAS by staff from separate departments has been practised by large audit firms for decades.

In contrast, the statement with the lowest mean score (2.43) was *The provision of NAS impairs audit quality*, which attracted agreement or strong agreement from only 16.9% of respondents.

The statement with the second lowest mean score (2.57) was *The provision of NAS to an audit client leads to economic dependency on that client and causes a conflict of interests for the auditor*. Just less than a third (30%) of respondents either agreed or strongly agreed with this statement. The statement with the third lowest mean score (3.26) was *Only certain types of NAS impair audit quality* and in this respect, 48.8% of audit firm respondents either agreed or strongly agreed with it.

Since the overall responses of oil companies and audit firms were not completely identical, an attempt was made to isolate the determinants of the disparities. Therefore, the extent to which position and type of audit firm might explain differences in oil company and audit firm respondents' opinions, was once again tested using the Kruskal-Wallis and Mann Whitney U tests.

Table 5.15, which documents the results, shows two significant differences at the 1% level, as measured by the Mann Whitney U test.

On examination of the level of agreement, oil company respondents were significantly higher than audit firm respondents in respect of the statement that the provision of NAS impairs audit quality. This difference in the responses is interesting, and perhaps suggests that audit firm respondents viewed the provision of NAS from the profit perspective, whereas oil companies viewed the provision of NAS as not impairing audit quality, but needing some restriction.

The level of agreement from oil company respondents was significantly higher than that from audit firm respondents in respect of the statement highlighting the advantages of the provision of NAS to an audit client as being that it gives the auditor more experience of the client's industry and more access to the client's accounting system. This result might reflect a preference of oil company respondents to receive the provision of NAS from their external auditor.

However, in general, the above results are consistent with prior literature (Abdel-Khalik, 1990; Craswell, 1999; De Fond et al, 2002) that identifies the provision of NAS to audit clients as having the potential to increase the auditor's client knowledge, and therefore, enhance the probability that problems would be discovered. Therefore, for a given level of independence, NAS may increase audit quality. Further, NAS may increase a client's dependence on its auditor, thereby reducing the credibility of the switch threat. Another commonly-mentioned advantage of providing NAS to audit clients is the potential cost advantage to the client arising from knowledge spillovers, which are transfers of knowledge that may occur when NAS are provided by the incumbent auditor

Table 5.15: Distribution of the Evaluations given by the Different Statements Regarding the Non-Audit Services (NAS) and Audit Quality

Statement	Audit Firms							Oil Companies							Sig
	SD %	D %	NV %	A %	SA %	Mean	Median	SD %	D %	NV %	A %	SA %	Mean	Median	
The provision of NAS to an audit client gives the auditor more experience of the client's industry and more access to the client's accounting system.	0	5.0	22.5	41.9	30.6	3.98	4.00	0	10.5	5.5	34.6	49.6	4.24	4.00	*
The provision of NAS to an audit client leads to economic dependency on that client and causes a conflict of interests for the auditor.	29.4	14.4	26.2	30	0	2.57	3.00	33.9	15.7	17.3	33.1	0	2.50	3.00	
Only certain types of NAS impair audit quality.	14.4	17.5	19.4	25	23.8	3.26	3.00	20.5	20.5	13.4	26	19.7	3.04	3.00	
The prohibition of the provision of NAS to an audit client is only to maintain the perception of independence.	5.6	16.3	19.4	31.9	26.9	3.58	4.00	7.1	16.5	28.3	26	22	3.39	3.00	
Providing NAS to an audit client by a separate department gives the auditor more credibility.	6.9	19.4	26.3	27.5	20	3.34	3.00	8.7	15	15.7	39.4	21.3	3.50	4.00	
The provision of NAS impairs audit quality.	17.5	45	20.6	11.3	5.6	2.43	2.00	11	33.9	31.5	8.7	15	2.83	3.00	*
The provision of NAS to an audit client reduces the probability of a threat to switch auditor.	5	11.9	31.3	28.8	23.1	3.53	4.00	15.7	22	11	27.6	22.8	3.20	4.00	

*,** indicates distribution of responses is significantly different at the 1%, 5% levels, respectively using the Mann Whitney U test

5.4.2.1 The Perceptions of NAS Based on Position

Table 5.16 shows that when comparing the responses of oil company staff and audit firm staff using the Kruskal-Wallis test, one significant difference (at the 5% level) is observed. Financial managers, accounts managers and internal auditors had significantly higher mean scores (4.32, 4.31 and 4.09) than audit supervisors and auditors (3.96 and 3.98) for the statement *The provision of NAS to an audit client gives the auditor more experience of the client's industry and more access to the client's accounting system*. This finding may be due to the belief of financial managers and internal auditors, who may feel that the non-provision of audit services improves audit quality, and believes that if NAS are not provided, more audit hours are needed for new auditor to become familiar with the company system. This result is consistent with that obtained by other researchers who support the provision of joint services, arguing that this arrangement ameliorates audit independence (Antle et al, 1997), because it provides the auditor with better knowledge of a client (through 'knowledge spillover'), and may well enhance the likelihood of problem discovery, and hence audit quality (Goldman and Barlev, 1974; Wallman, 1996).

Table 5.16: Distribution of the Evaluations given by the Different Statements Regarding the Non-Audit Services (NAS) based on Position

Statement	Audit Firm Staff						Oil Company Staff						Sig
	Managing Partner		Audit Supervisor		Auditor		Internal Auditor		Financial Manager		Accounts Manager		
	Mean	Median	Mean	Median	Mean	Median	Mean	Median	Mean	Median	Mean	Median	
The provision of NAS to an audit client gives the auditor more experience of the client's industry and more access to the client's accounting system.	4.00	4.00	3.96	4.00	3.98	4.00	4.09	4.00	4.32	5.00	4.31	5.00	**
The provision of NAS to an audit client leads to economic dependency on that client and causes a conflict of interests for the auditor.	2.48	3.00	2.67	3.00	2.55	3.00	2.82	3.00	2.38	2.00	2.23	2.00	
Only certain types of NAS impair audit quality	3.50	4.00	3.23	3.00	3.07	3.00	3.24	3.00	3.09	3.00	2.71	2.00	
The prohibition of the provision of NAS to an audit client is only to maintain the perception of independence.	3.88	4.00	3.29	3.50	3.57	4.00	3.29	3.00	3.23	3.00	3.74	4.00	
Providing NAS to an audit client by a separate department gives the auditor more credibility.	3.33	3.00	3.27	3.00	3.43	4.00	3.76	4.00	3.13	3.00	3.66	4.00	
The provision of NAS impairs audit quality.	2.27	2.00	2.48	2.00	2.52	2.00	2.82	3.00	2.72	2.00	2.97	3.00	
The provision of NAS to an audit client reduces the probability of a threat to switch auditor.	3.50	3.00	3.40	3.50	3.68	4.00	3.16	3.00	3.21	4.00	3.23	3.00	

*, ** indicates distribution of responses is significantly different at the 1%, 5% levels, respectively using the Kruskal-Wallis test

5.4.2.2 The Perceptions of NAS Based on Type of Audit Firms

The analysis by type of audit firm, as reported in Table 5.17, shows that no significant differences were found at the 5% level, and that just one significant difference was found at the 1% level between local audit firms, local firms affiliated to an international firm, and local firms affiliated to one of the Big Four audit firms (non-Big Four and Big Four) using the Kruskal Wallis test.

The level of agreement with the statement: *Only certain types of NAS impair audit quality* was significantly higher from local audit firms and international audit firms (non-Big Four) (3.58 and 2.86) than from the Big Four firm respondents (2.62). This result might reflect the fact that the Big Four firm respondents believe that all types of NAS can potentially impair the level of audit quality, or pose a threat to auditor independence.

This finding is inconsistent with the reports of Abu Bakar et al (2005) and Alleyne and Devonish (2006) who found that individual non-audit services may affect auditor independence influence audit quality perceptions differently and that the provision of NAS is a significant threat to perceptions of auditor independence.

Table 5.17: Distribution of the Evaluations given by the Different Statements Regarding Non-Audit Services (NAS) based on Type of Audit Firm

Statement	Local Audit Firm		International Audit Firm		Big Four Audit Firm		Sig
	Mean	Median	Mean	Median	Mean	Median	
The provision of NAS to an audit client gives the auditor more experience of the client's industry and more access to the client's accounting system.	4.00	4.00	4.07	4.00	3.71	4.00	
The provision of NAS to an audit client leads to economic dependency on that client and causes a conflict of interests for the auditor.	2.63	3.00	2.53	3.00	2.38	2.00	
Only certain types of NAS impair audit quality.	3.58	4.00	2.86	3.00	2.62	2.00	*
The prohibition of the provision of NAS to an audit client is only to maintain the perception of independence.	3.63	4.00	3.56	4.00	3.43	3.00	
Providing NAS to an audit client by a separate department gives the auditor more credibility.	3.38	3.00	3.42	4.00	3.05	3.00	
The provision of NAS impairs audit quality.	2.39	2.00	2.58	2.00	2.29	2.00	
The provision of NAS to an audit client reduces the probability of a threat to switch auditor.	3.50	4.00	3.63	4.00	3.48	5.00	
*,** indicates distribution of responses is significantly different at the 1%, 5% levels, respectively using the Kruskal-Wallis test							

5.4.3 The Length of Audit Tenure

The respondents were asked to indicate their views on issues relating to the relationship between the length of audit tenure and audit quality and the analysis of their responses is reported in Table 5.18. From this it can be seen that the statement *A policy of mandatory rotation leads to reduction in any relationship between the client and auditor* had the highest mean score (3.90) based on oil company respondents' opinions, as many as 80.3% of whom either agreed or strongly agreed with this statement. The statement with the second and third highest mean scores (3.85) was *Long tenure with a client impairs auditor independence*. Oil company respondents (69.3%) either agreed or strongly agreed with it. The statements with the third highest mean score (3.50 and 3.49) were *The auditor will not become economically dependent by specifying a period of tenure* and *The mandatory rotation is positively associated with audit quality* that attracted 52% and 63% of respondents agreement or strong agreement. The statement with the fourth highest mean score (3.34) was *Long tenure with a client gives an auditor more experience and leads to lower audit hours* which attracted either agreement or strong agreement from 48.8% of respondents.

In contrast, the statements *Mandatory rotation harms the technical competence of auditing and leads to reduction in knowledge and familiarity with the client's accounting system*, *Mandatory rotation makes the audit market less competitive and causes higher audit fees* and *Long tenure should only be allowed with large companies* achieved the lowest, second lowest and third lowest mean scores (2.52; 2.60 and 2.65, respectively).

Regarding audit firm respondents' opinions, Table 5.18 reveals that the same number of oil companies (77.5%) either agreed or strongly agreed with the statement that

Policy of mandatory rotation leads to reduction in any relationship between the client and auditor. It had a mean score of (3.99). The statements *Long tenure with a client gives an auditor more experience and leads to lower audit hours* and *The auditor will not become economically dependent by specifying a period of tenure* obtained the second and third highest mean scores (3.93 and 3.81, respectively), with 77.6% and 64.4% respectively of respondents either agreeing or strongly agreeing with the former and the latter. The statements with the fourth and fifth highest mean scores (3.59; 3.40 respectively) were *Mandatory rotation is positively associated with audit quality* and *Long tenure with a client impairs auditor independence* with 72.5% and 55.3% respectively of respondents either agreeing or strongly agreeing with them.

In contrast, the statements that achieved the lowest, second lowest and third lowest mean scores (2.56, 2.62 and 2.91, respectively) were *Mandatory rotation harms the technical competence of auditing and leads to reduction in knowledge and familiarity with the clients accounting system*, *Long tenure should only be allowed with large companies* and *Mandatory rotation makes the audit market less competitive and causes higher audit fees* respectively. The majority of oil companies and audit firms agreed with all the advantages of mandatory rotation. This finding is consistent with prior literature, for example Dopuch et al (2001) found that rotation requirements decreased auditor-subjects' willingness to issue biased reports, Abu Bakar et al (2005) found that the mandatory rotation of auditor promotes the perception of auditor independence, and Sandra et al (2007) reported that audit firm rotation appeared to enhance perception of auditor independence but noting at the same time that the rotation of the audit partner did not change the level of confidence in reported earnings, and that auditors would not become economically dependent on any one client.

Once again, the overall responses gained in this study were not completely homogeneous. Thus, an attempt was made to isolate the determinants of responses according to whether they came from oil companies or audit firms. The overall sample was analysed by (1) position of respondents, and (2) type of audit firm, using the Kruskal-Wallis and Mann Whitney U tests.

Table 5.18 shows the analysis comparing the oil company and audit firm respondents. It reveals three statistically significant differences in responses at a level of 5%, and one statistically significant difference at the 1% level when using the Mann Whitney test.

The level of agreement with the statement *Long tenure with a client impairs auditor independence* was significantly higher from oil company respondents (3.85 mean score) than from audit firm respondents (3.40 mean score). The level of agreement with the statements *The auditor will not become economically dependent by specifying a period of tenure* and *Long tenure with a client gives an auditor more experience and leads to lower audit hours* were significantly higher in audit firm respondents (3.81 and 3.93 mean scores, respectively) than oil company respondents (3.50 and 3.34 mean scores, respectively). This result might reflect the lack of preference among the oil companies for long tenure. Additionally, it might suggest a preference among audit firms for long tenure with clients rather than mandatory rotation. This finding supports that of Winters (1976) who reports that auditors who serve a client over a continuous period of time tend to become impaired in their independence to inform and protect the public, since they may overly comply with management's desire to exercise some flexibility in reporting the results of operations.

It is inconsistent with the finding of Jackson et al (2008) who observed audit quality to increase with audit firm tenure.

Another statistically significant difference in responses at a level of 5% in respect of the amount of agreement with the statement *Mandatory rotation makes the audit market less competitive and causes higher audit fees* was significantly higher in audit firm respondents (2.91 mean score) than oil company respondents (2.60 mean score). This result might reflect oil company respondents' support for the argument that the rotation of auditors would lead to greater competition between auditing firms which would enhance the quality of the service that they offered since if companies have to frequently change auditors, firms will seek to position themselves in the market through offering work of a high quality.

Moreover, neither oil company nor audit firm respondents were in favour of large companies being allowed to engage external auditors for a long tenure, which is inconsistent with the argument of Hoyle (1978) that the complexity and size of most modern businesses simply do not allow short audit engagements, as it would take any external auditor some time to become acquainted with a company's business systems and audit needs.

Table 5.18: Distribution of the Evaluations given by the Different Statements Regarding the Length of Audit Tenure and Audit Quality

Statement	Audit Firms								Oil Companies								Sig
	SD %	D %	NV %	A %	SA %	Mean	Median	SD %	D %	NV %	A %	SA %	Mean	Median			
Policy of mandatory rotation leads to reduction in any relationship between the client and auditor	4.4	0	18.1	47.5	30	3.99	4.00	6.3	7.9	5.5	50.4	29.9	3.90	4.00			
Mandatory rotation is positively associated with audit quality.	10.6	16.9	0	48.1	24.4	3.59	4.00	11	15	11	40.2	22.8	3.49	4.00			
Long tenure with a client impairs auditor independence.	10.6	19.4	13.8	31.9	24.4	3.40	4.00	9.4	21.3	0	44.1	25.2	3.85	4.00			
Long tenure with a client gives an auditor more experience and leads to lower audit hours	7.5	5.6	9.4	41.3	36.3	3.93	4.00	8.7	22.8	19.7	23.6	25.2	3.34	3.00			
Long tenure should only be allowed with large companies	23.1	28.1	24.4	12.5	11.9	2.62	2.00	25.2	26.0	20.5	15	13.4	2.65	2.00			
Mandatory rotation harms the technical competence of auditing and leads to reduction in knowledge and familiarity with the clients accounting system.	21.9	30.6	23.8	16.9	6.9	2.56	2.00	22.8	31.5	22	18.1	5.5	2.52	2.00			
Mandatory rotation makes the audit market less competitive and causes higher audit fees.	14.4	27.5	26.3	16.3	15.6	2.91	3.00	22	30.7	18.9	22	6.3	2.60	2.00			
The auditor will not become economically dependent by specifying a period of tenure.	3.8	11.9	20	28.1	36.3	3.81	4.00	7.1	18.1	22.8	21.3	30.7	3.50	4.00			

*, ** indicates distribution of responses is significantly different at the 1%, 5% levels, respectively using the Mann Whitney U test

5.4.3.1 The Perceptions of Length of Audit Tenure Based on Position

The result in Table 5.19 shows the analysis by position revealing some statistically significant differences in responses using the Kruskal-Wallis test. Two significant differences were found at the 1% level and one at the 5% level of significance.

The level of agreement with the statement: *Long tenure with a client impairs auditor independence* was significantly higher in the responses from financial managers and accounts managers (4.00 and 3.91) than in those from auditors and audit supervisors (2.96 and 3.48 mean scores, respectively). This finding supports the findings of Winters (1976) who observes that auditors who serve a client over a continuous period of time tend to become impaired in their independence to inform and protect the public, since they may overly comply with management's desire to exercise some flexibility in reporting the results of operations. In the present study, the results may be attributed to the fact that financial managers and accounts managers know the accounting system in the company better than auditors and hence know the influence of companies engaging the same auditors over a long period on audit quality in terms of audit hours, personal relationships with company management, etc.

On examination of the level of agreement with the statement *Long tenure with a client gives an auditor more experience and leads to lower audit hours* it was shown that this was significantly higher in auditor and audit supervisor respondents (4.00 and 3.98) than in financial managers and internal auditors (3.23 and 3.31 mean scores respectively). These findings may be due to the fact that the auditors and audit supervisors prefer long tenure rather than mandatory rotation, with their clients, for several reasons, e.g. long tenure gives auditors the opportunity to develop more knowledge, experience and familiarity with clients' accounting systems, and

ultimately eases their job. However, it is considered that where the same auditor audits a client for a number of years a degree of carelessness intrudes into their work and, therefore, the quality of auditing would be enhanced if a fresh approach were brought periodically to corporate audits (Brody and Moscové, 1998). In the early years of an audit assignment, the approach to audit is likely to be innovative but with the passage of time, the audit programme may become tired as the auditor is able to predict what the condition of the client's systems will be as well as the control procedures.

Another significant difference at the 5% level was found in respect of the statement *Long tenure should only be allowed with large companies*. Internal auditors had a significantly higher mean score (3.07) than audit supervisors (2.33) and accounts managers (2.34). This finding may be due to internal auditor recognition that external auditors need a longer time with large companies in order to understand their accounting systems. If external auditors change periodically, demands will be made on financial managers' time and resources, as they will need to introduce them to company practices and systems, as reported by Johnson et al (2002), who state that short duration relationships between auditors and clients weaken client-specific knowledge in the early years of an engagement, resulting in the lesser likelihood of detecting material misstatements. Therefore, auditors have a comparative advantage in detecting errors over time as they obtain a deeper understanding of the client's business.

Table 5.19: Distribution of the Evaluations given by the Different Statements Regarding the Length of Audit Tenure based on Position

Statement	Audit Firm Staff						Oil Company Staff						Sig
	Managing Partner		Audit Supervisor		Auditor		Internal Auditor		Financial Manager		Accounts Manager		
	Mean	Median	Mean	Median	Mean	Median	Mean	Median	Mean	Median	Mean	Median	
Policy of mandatory rotation leads to reduction in any relationship between the client and auditor	4.02	4.00	4.06	4.00	3.89	4.00	3.96	4.00	3.79	4.00	3.97	4.00	
Mandatory rotation is positively associated with audit quality.	3.54	4.00	3.77	4.00	3.46	4.00	3.29	4.00	3.55	4.00	3.66	4.00	
Long tenure with a client impairs auditor independence.	3.79	4.00	3.48	4.00	2.96	3.00	3.64	4.00	4.00	4.00	3.91	4.00	*
Long tenure with a client gives an auditor more experience and leads to lower audit hours	3.81	4.00	4.00	4.00	3.98	4.00	3.31	3.00	3.23	3.00	3.51	4.00	*
Long tenure should only be allowed with large companies.	2.77	3.00	2.33	2.00	2.75	3.00	3.07	3.00	2.49	2.00	2.34	2.00	**
Mandatory rotation harms the technical competence of auditing and leads to reduction in knowledge and familiarity with the clients accounting system.	2.48	2.50	2.58	2.00	2.63	2.50	2.60	2.00	2.68	3.00	2.20	2.00	
Mandatory rotation makes the audit market less competitive and causes higher audit fees.	2.87	3.00	2.96	3.00	2.91	3.00	2.62	3.00	2.85	3.00	2.23	2.00	
The auditor will not become economically dependent by specifying a period of tenure.	3.90	4.00	3.71	4.00	3.82	4.00	3.29	3.00	3.43	4.00	3.89	4.00	

*, ** indicates distribution of responses is significantly different at the 1%, 5% levels, respectively using the Kruskal-Wallis test

5.4.3.2 Perceptions of Length of Audit Tenure Based on Type of Audit Firm

The analysis by type of audit firm, as reported in Table 5.20, shows that three significant differences were found at the 5% level of significance between local audit firms, local firms affiliated to an international firm, and local firms affiliated to one of the Big Four audit firms (non-Big Four and Big Four) using the Kruskal-Wallis test.

Table 5.20 shows that the level of agreement with the statement that *The policy of mandatory rotation leads to a reduction in any relationship between the client* was significantly higher in respect of the Big Four audit firms (4.48 mean score) than in non-Big Four audit firms (4.05 and 3.85), at the 5% level of significance. The proponents of mandatory rotation indicated that it would improve audit quality, enhance auditor objectivity, and provide a 'fresh look' at clients' financial statements. It may be the case that the responses from the Big Four might be a sign of their agreement that auditors who are aware of their limited engagement period would examine their clients' accounts more objectively, be less afraid to upset clients by issuing negative reports, and be in a stronger position to resist management pressure (see for example, Gietzman and Sen, 2002).

Another significant difference found at the 5% level was in respect of the agreement with the statement that *Mandatory rotation makes the audit market less competitive and causes higher audit fees*. The level of agreement was significantly higher in non-Big Four respondents (3.16 and 2.96 mean scores respectively) than in Big Four respondents (2.19 mean score).

Table 5.20 shows one significant difference at the 5% level of significance, that being in relation to the statement *Long tenure with a client gives an auditor more experience*

and leads to lower audit hours. The agreement was significantly higher in Big Four respondents (4.38 mean score) than in international audit firm and local audit firm (non-Big Four) respondents (3.70 and 3.94, respectively). These findings may be due to the fact that the Big Four audit firms preferred long tenure rather than mandatory rotation with their clients. Indeed, long tenure would reduce the positive risk caused by incoming auditors who may show a lack of knowledge about the client's business and the associated cost inefficiencies which could hinder effective auditing in the early years of the engagement period. This finding is consistent with the observation of Jackson et al (2008) who reported that audit quality increases with audit firm tenure. Similarly, Chen et al (2008) found that audit quality improved with audit partner tenure in the 1990-2001 periods before audit partner rotation became mandatory in Taiwan. Mansi et al (2004) also found that longer audit firm tenure is associated with higher bond ratings and a lower cost of debt.

Table 5.20: Distribution of the Evaluations given by the Different Statements Regarding the Length of Audit Tenure based on Type of Audit Firm

Statement	Local Audit Firm		International Audit Firm		Big Four Audit Firm		Sig
	Mean	Median	Mean	Median	Mean	Median	
	A policy of mandatory rotation leads to reduction in any relationship between the client and auditor	3.85	4.00	4.05	4.00	4.48	
Mandatory rotation is positively associated with audit quality.	3.44	4.00	3.67	4.00	4.10	4.00	
Long tenure with a client impairs auditor independence.	3.52	4.00	3.42	4.00	2.81	2.00	
Long tenure with a client gives an auditor more experience and leads to lower audit hours	3.94	4.00	3.70	4.00	4.38	5.00	**
Long tenure should only be allowed with large companies.	2.59	3.00	2.63	2.00	2.71	3.00	
Mandatory rotation harms the technical competence of auditing and leads to reduction in knowledge and familiarity with the clients accounting system.	2.64	2.00	2.49	3.00	2.38	2.00	
Mandatory rotation makes the audit market less competitive and causes higher audit fees.	2.96	3.00	3.16	3.00	2.19	2.00	**
The auditor will not become economically dependent by specifying a period of tenure.	3.75	4.00	4.07	4.00	3.57	4.00	

*, ** indicates distribution of responses is significantly different at the 1%, 5% levels, respectively using the Kruskal-Wallis test

5.4.4 The Level of Competitiveness in the Audit Market

Table 5.21 shows that 81.1% of oil company respondents either agreed or strongly agreed with the statement *The audit market in Libya is highly competitive*. This statement achieved the highest mean score (3.79).

In contrast, less than a quarter of oil company respondents (26%) either agreed or strongly agreed with the statement *Audit quality may be impacted if the audit firm operates in a highly competitive environment*. This statement achieved the second lowest mean score of (2.72). The statement with the lowest mean score (2.54) was *Audit quality may be impacted if there is audit fee discounting or low-balling at initial engagement*. The percentage of respondents either agreed or strongly agreed with this opinion was 32.2%. Regarding audit firm respondents' opinions, Table 5.21 shows that the statement *The audit market in Libya is highly competitive* achieved the same highest mean score of (3.71), with (72.5%) of respondents either agreeing or strongly agreeing with it.

In contrast, the statement with the lowest mean score (2.64) was *Audit quality may be impacted if the audit firm operates in a highly competitive environment*. Just a quarter (25%) of respondents either agreed or strongly agreed with this opinion. The statement with the second lowest mean score (2.41) was *Audit quality may be impacted if there is audit fee discounting or low-balling at initial engagement*. Under a quarter (30.1%) of respondents either agreed or strongly agreed with this idea.

Oil company and audit firm responses were not completely identical, so an attempt was made to isolate the determinants of answers using the Mann Whitney U test. Table 5.21 shows no significant differences in the distribution of responses at either the 1% level or 5% level of significance.

Table 5.21: Distribution of the Evaluations given by the Different Statements Regarding the Competition in the Audit Market and Audit Quality

Statement	Audit Firms							Oil Companies							Sig
	SD %	D %	NV %	A %	SA %	Mean	Median	SD %	D %	NV %	A %	SA %	Mean	Median	
The audit market in Libya is highly competitive.	4.4	0	23.1	65.6	6.9	3.71	4.00	1.6	2.4	15	78	3.1	3.79	4.00	
Audit quality may be impacted if the audit firm operates in a highly competitive environment.	25.6	26.9	22.5	8.1	16.9	2.64	2.00	17.3	33.9	22.8	11.8	14.2	2.72	2.00	
Audit quality may be impacted if there is audit fee discounting or low-balling at initial engagement.	37.5	32.5	0	11.3	18.8	2.41	2.00	37.8	25.2	4.7	10.2	22	2.54	2.00	

*,** indicates distribution of responses is significantly different at the 1%, 5% levels, respectively using the Mann Whitney U test

5.4.4.1 The Level of Competition in the Audit Market Based on Position

The analysis by position revealed no significant differences in the distribution of oil company and audit firm responses at either the 1% or 5% levels of significance, so the analysis by position is not reported.

5.4.4.2 The Level of Competition in the Audit Market Based on Type of Audit Firm

The analysis of the difference in responses is reported in Table 5.22, which shows one significant difference at the 5% level, as measured by using the Kruskal Wallis test. The level of agreement with the statement that *Audit quality may be impacted if the audit firm operates in a highly competitive environment* was significantly higher from local, Arab, and international audit firms (non-Big Four audit firms) (2.89 and 2.37 mean scores) than from Big Four audit firms (2.05 mean score), at the 5% level of significance. This might reflect the unwillingness of the Big Four firms to acknowledge any problems that a highly competitive environment might bring. The result seems to indicate that the Big Four firms react by taking steps to protect the profession's image, responding in a way that indicates their high levels of confidence in their professionalism (Teoh and Lim, 1996). Another possible reason for this view is that competition in the audit market for large companies exists among large audit firms and a small number of medium size audit firms, due to their capability to offer an adequately-sized bundle of resources. The smaller and medium-sized audit firms have shortcomings concerned with the lack of staff, inadequate industrial and technical expertise, and insufficient global reach to satisfy the large companies' audit requirements (see GAO, 2003a; Mautz and Sharaf, 1961), and the Big Four audit firms would carefully protect their reputation from audit failure.

Table 5.22: Distribution of the Evaluations given by the Different Statements Regarding the Competitive Market based on Type of Audit Firm

Statement	Local Audit Firm		International Audit Firm		Big Four Audit Firm		Sig
	Mean	Median	Mean	Median	Mean	Median	
The audit market in Libya is highly competitive.	3.71	4.00	3.77	4.00	3.57	4.00	
Audit quality may be impacted if the audit firm operates in a highly competitive environment.	2.89	3.00	2.37	2.00	2.05	2.00	**
Audit quality may be impacted if there is audit fee discounting or low-balling at initial engagement.	2.38	2.00	2.19	2.00	3.05	2.00	

* ** indicates distribution of responses is significantly different at the 1%, 5% levels, respectively using the Kruskal-Wallis test

5.4.5 Fees for Audit Services

Oil company and audit firm respondents' perceptions of the relationship between audit fees and audit quality are indicated in Table 5.23. According to the oil company respondents, the statement with the highest mean score (3.81) is *An audit firm that charges high audit fees usually spends more audit hours with its clients and is most likely to provide high audit quality*. As many as 70.8% of oil company respondents either agreed or strongly agreed with this statement. The statement with the second highest mean score (3.76) was *The Big Four firms usually charge higher audit fees and local firms usually charge lower audit fees*. The oil company respondents (67.7%) either agreed or strongly agreed with this opinion. The statement with the third highest mean score of (3.69) *Audit fee is positively associated with audit quality*. As many as 70.8% of the oil company respondents either agreed or strongly agreed with it. The statement that had the fourth highest mean score (3.45) was *Audit fees that are specified by an independent professional body will lead to higher audit quality* and 59% of respondents reported either agreeing or strongly agreeing with it. The fifth highest mean score (3.39) was recorded for the statement *Audit fees are increased to allow more thorough scrutiny of the clients accounting system*. Just half of respondents (49.6%) either agreed or strongly agreed with it.

The statement that had the lowest mean score (2.71) was *A company that pays higher audit fees is more likely to receive a clean audit opinion*. Just over a third of respondents (37.7%) either agreed or strongly agreed with it.

The statement that had the second lowest mean score (3.05) was *A company that is receiving NAS from its external auditor is most likely to be charged lower audit fees*. As many as 40.2% of the oil company respondents either agreed or strongly agreed

with this suggestion. The third lowest mean score (3.14) was *Audit fees remaining between a specified minimum and maximum amount will result in higher audit quality* with 45.7% of respondents either agreeing or strongly agreeing with it.

Turning to audit firm respondents' opinions, Table 5.23 shows that the statement with the highest mean score (3.79) was *The Big Four firms usually charge higher audit fees and local firms usually charge lower audit fees* with as many as 71.3% of audit firm respondents either agreeing or strongly agreeing with it. The statement *An audit firm that charges high audit fees usually spends more audit hours with its clients and is most likely to provide high audit quality* achieved the second highest mean score (3.74), with 68.2% of audit firm respondents in agreement. The statement with the third highest mean score (3.65), and 75.1% of respondents supporting it, was *The audit fee is positively associated with audit quality*. The statement *Audit fees that are specified by an independent professional body will lead to higher audit quality* achieved the fourth highest mean score (3.46), and 60.7% of respondents supported it. The fifth highest mean score (3.34) was recorded for the statement *Audit fees are increased to allow more thorough scrutiny of the client's accounting system*. Over half of respondents (51.2%) either agreed or strongly agreed with this.

The statement that had the lowest mean score (2.71) was *A company that pays higher audit fees is more likely to receive a clean audit opinion*. The statement that had the second lowest mean score (2.72) was *A company that is receiving NAS from its external auditor is most likely to be charged lower audit fees*. The third lowest mean score (3.29) was *Audit fees are increased to allow more thorough scrutiny of the client's accounting system*.

By comparing the responses from the oil company and audit firm participants, it can be seen that both samples agreed that the *audit fee is positively associated with audit quality* (70.8 % and 75.1% either agreeing and strongly agreeing, respectively) and it may be noted that oil company respondents agreed that the Big Four audit firms usually charge higher audit fees (74.8%), which is consistent with some researchers' findings that there is a large price premium on the Big Eight, now Four, auditors, and hence they conclude that the observation of systematic price differences between large and small auditing firms evidences product differentiation between large firms, and more importantly, that higher prices were consistent with higher quality audits (see, for example; Francis, 1984; Palmrose, 1986a; Gist and Pavlos, 1995). However, oil company respondents were more conservative about the idea that the increase in audit fees would allow more thorough scrutiny of a client's accounting system (57.5%), and hence provide high audit quality. Audit firm respondents agreed on the concept, and that might be due to the nature of their work, since they are representing the supply side in the market.

Once again, overall responses were not completely homogeneous. Thus, an attempt was made to isolate the determinants of responses by oil company and audit firm respondents, using the Mann Whitney U tests.

Table 5.23 shows one significant difference at the 5% level of significance indicating that the level of agreement among oil company respondents was significantly higher (3.05 mean score) than among audit firm respondents (2.72 mean score) for the statement *A company receiving Non-Audit Service (NAS) from its external auditor is most likely to be charged lower audit fees*. This finding is not surprising since audit

firms prefer to provide NAS to their clients and will not, therefore, support this statement.

This result is inconsistent with the observations of Firth (1997a) who examined the determinants of audit fees, derived explanatory models used to predict future fees, and reported a negative association between audit fees and consultancy fees based on whether the audit is used as a loss leader and/or whether there are reductions in audit costs, which are returned to clients via lower audit fees. The latter finding supports the result of the analysis of NAS (see section 5.4.2) as presented in Table 5.15

Table 5.23: Distribution of the Evaluations given by the Different Statements Regarding the Fees for Audit Services and Audit Quality

Statement	Audit Firms										Oil Companies					
	SD %	D %	NV %	A %	SA %	Mean	Median	SD %	D %	NV %	A %	SA %	Mean	Median	Sig	
The audit fee is positively associated with audit quality.	6.3	18.8	0	53.8	21.3	3.65	4.00	7.1	11	11	48	22.8	3.69	4.00		
An audit firm that charges high audit fees usually spends more audit hours with its clients and is most likely to provide high audit quality.	11.9	9.4	10.6	29.4	38.8	3.74	4.00	3.9	17.3	7.9	35.4	35.4	3.81	4.00		
Audit fees that are specified by an independent professional body will lead to higher audit quality.	10	18.1	11.3	36.9	23.8	3.46	4.00	14.2	15	11.8	29.9	29.1	3.45	4.00		
Audit fees are increased to allow more thorough scrutiny of the clients accounting system.	13.1	16.9	18.8	25.6	25.6	3.34	4.00	13.4	23.6	5.5	26	31.5	3.39	4.00		
A company that pays higher audit fees is more likely to receive a clean audit opinion.	29.4	13.8	22.5	25.6	8.8	2.71	3.00	29.3	16.3	16.4	28.6	9.1	2.71	3.00		
A company that is receiving NAS from its external auditor is most likely to be charged lower audit fees	23.1	24.4	22.5	17.5	12.5	2.72	3.00	17.3	21.3	21.3	19.7	20.5	3.05	3.00	**	
The Big Four firm usually charge higher audit fees and local firms usually charge lower audit fees	8.1	14.4	6.3	32.5	38.8	3.79	4.00	5.5	11.8	15.0	36.2	31.5	3.76	4.00		
Audit fees remaining between a specified minimum and maximum amount will result in higher audit quality.	12.5	18.8	15.6	33.1	20	3.29	4.00	14.2	18.1	22	30.7	15	3.14	3.00		

*, ** indicates distribution of responses is significantly different at the 1%, 5% levels, respectively using the Mann Whitney U test

5.4.5.1 Fees for Audit Services Based on Position

The analysis by position revealed no significant differences in the distribution of oil company and audit firm respondents' opinions at either the 1% or 5% level of significance, so the analysis by position is not reported.

5.4.5.2 Fees for Audit Services Based on Type of Audit Firm

Table 5.24 presents the analysis of significant differences between local audit firms, local firms affiliated to an Arab or international audit firm, and local firms affiliated to one of the Big Four audit firms (non-Big Four and Big Four) by type of audit firm. The Kruskal-Wallis test revealed two significant differences at the 1% level of significance and one significant difference at the 5% level.

The level of agreement for two statements, namely, *The audit fee is positively associated with audit quality* and *Audit fees that are specified by an independent professional body will lead to higher audit quality* was significantly higher for Big Four audit firm respondents than it was for local, Arab, and international audit firm (non-Big Four) respondents. This result is not surprising since non-Big Four audit firms claim that they cannot provide such high quality audits as Big Four audit firms, as long as large companies continue to pay them less for their audit services than Big Four audit firms. It also suggests that Big Four audit firms customarily receive higher audit fees than others, and that may be due to their high reputation and global reach. That result could indicate that there might be a large premium to local audit firms affiliated to one of the Big Four audit firms, which is consistent with the findings by Palmrose (1986a) who reported a premium for what were then the Big Eight audit firms.

O'Keefe and Westort (1992) highlighted the fact that personnel in large firms engaged in a greater degree of specialisation, and there is evidence that CPAs in larger firms engage in significantly more continuing professional education than CPAs in small firms. Therefore, the technological knowledge of audit teams in Big Four audit firms is likely to be greater than in small firms, and hence the detection and correction of errors will also be greater. The finding shows further satisfaction among Big Four audit firms and their desire for an independent body to specify the amount of audit fees paid to all audit firms.

In addition, the level of agreement of Big Four audit firm respondents was significantly higher (4.05 mean score) than among local and international audit firm (non-Big Four) respondents (3.24 and 3.05 mean score) for the statement *Audit fees remaining between a specified minimum and maximum amount will result in higher audit quality*. This mismatch in the responses of Big Four and non-Big Four audit firm respondents is interesting, and may be due to the fact that non-Big Four audit companies want more freedom to negotiate their audit fees. Such findings are also supported by Francis (1984) who concluded that the observation of systematic price differences between large and small auditing firms was evidence that higher fees were consistent with higher quality audits, and Deis and Giroux (1996) who indicated that both audit fees and audit hours were significantly related to audit quality in a manner consistent with the explanation that audits are differentiated products in the market. More importantly, they found that both audit fees and audit hours were influenced by audit quality, and audit hours and audit quality were higher among initial audits.

Table 5.24: Distribution of the Evaluations given by the Different Statements Regarding the Fees for Audit Services Based on Type of Audit Firm

Statement	Local Audit Firm		International Audit Firm		Big Four Audit Firm		Sig
	Mean	Median	Mean	Median	Mean	Median	
The audit fee is positively associated with audit quality.	3.52	4.00	3.67	4.00	4.19	4.00	**
An audit firm that charges high audit fees usually spends more audit hours with its clients and is most likely to provide high audit quality.	3.68	4.00	3.72	4.00	4.05	4.00	
Audit fees that are specified by an independent professional body will lead to higher audit quality.	3.46	4.00	3.07	3.00	4.29	4.00	*
Audit fees are increased to allow more thorough scrutiny of the clients accounting system.	3.23	4.00	3.37	3.00	3.76	4.00	
A company that pays higher audit fees is more likely to receive a clean audit opinion.	2.74	3.00	2.65	3.00	2.67	3.00	
A company that is receiving NAS from its external auditor is most likely to be charged lower audit fees	2.75	3.00	2.42	2.00	3.19	3.00	
The Big Four firm usually charge higher audit fees and local firms usually charge lower audit fees	3.79	4.00	4.00	4.00	3.38	4.00	
Audit fees remaining between a specified minimum and maximum amount will result in higher audit quality.	3.24	4.00	3.05	3.00	4.05	4.00	*
*, ** indicates distribution of responses is significantly different at the 1%, 5% levels, respectively using the Kruskal-Wallis test							

5.5 Analysis of Section D of the Questionnaire

5.5.1 Future Development of Audit Quality in Libya

In an attempt to obtain some insight into the envisaged future development of audit quality in Libya, both groups of respondents were asked to indicate on a scale ranging from 1 to 5 (where 1 signified strongly disagree and 5 represented strongly agree), the extent to which they agreed or disagreed with each of the statements presented in Table 5.25 below.

The statement relating to whether *Audit firms in Libya should be restricted to undertaking only audit work* had the highest mean score (3.97) based on oil company respondents, as many as 75.6% of whom either agreed or strongly agreed, with this opinion. The statement covering whether *The percentage of NAS income for audit firms should not be higher than 25% of total audit firm revenue generated from a single client* had the second highest mean score (3.94), with as many as 80.3% of respondents either agreeing or strongly agreeing with it. The statement with the third highest mean score (3.76) was *The current auditing rules and regulations need to be much improved*. As many as 69.3% either agreed or strongly agreed with it. The fourth highest mean score (3.67) was recorded for the statement *The LAAA should adopt international auditing and accounting standards to improve audit quality and should have strict requirements for granting audit licenses*. Again, less than three-quarters of respondents (70.9%) either agreed or strongly agreed with it. The fifth highest mean score (3.63) was recorded for the statement *There should be legal and disciplinary actions available to the authorities against non-compliant and dishonest auditors*. Over half of the respondents (64.5%) either agreed or strongly agreed with this belief.

Statements with the third, second lowest and lowest mean scores were *Audit firms should disclose the type and amount of NAS provided to their audit clients and oil companies should disclose the amount of audit and NAS fees paid in the annual report, Audit firms in Libya should adhere to audit quality requirement, and A range of audit fees should be specified by the Libyan regulatory authorities that allocates audit clients to audit firms* (3.58, 3.33 and 2.81 respectively).

With respect to audit firm respondents, Table 5.25 shows that the majority (76.8%) either agreed or strongly agreed with the statement *The current auditing rules and regulations need to be much improved*. This statement achieved a mean score of (3.91), almost the same as for the oil company respondents. The statement with the second highest mean scores was *The LAAA should adopt international auditing and accounting standards to improve audit quality and should have strict requirements for granting audit licenses* (3.63). As many as 67.6% of respondents either agreed or strongly agreed with this statement.

The statement with the third highest mean score (3.52) was that *There should be legal and disciplinary actions available to the authorities against non-compliant and dishonest auditors*. As many as 62.5% either agreed or strongly agreed with it. The fourth highest mean score (3.43) was recorded for the statement *Audit firms in Libya should adhere to audit quality requirements*. Again, less than three-quarters of respondents (61.2%) either agreed or strongly agreed with it. The fifth highest mean score (3.39) was recorded for the statement *Audit firms should disclose the type and amount of NAS provided to their audit clients and oil companies should disclose the amount of audit and NAS fees paid in the annual report*. Exactly half (50%) of respondents either agreed or strongly agreed with this sentiment.

Statements with the third, second lowest and lowest mean scores were *The percentage of NAS income for audit firms should not be higher than 25% of total audit firm revenue generated from a single client*, *Audit firms in Libya should be restricted to undertaking only audit work*, and *A range of audit fees should be specified by the Libyan regulatory authorities that allocates audit clients to audit firms* (3.33, 3.14 and 3.11, respectively). As can be noted from the descriptive analysis of oil company and audit firm respondents presented below, their responses are similar. The analysis of significant differences between oil company and audit firm responses produced two significant differences at the 1% level and one at the 5% level of significance, as measured by the Mann Whitney U test (see Table 5.25).

A further interesting difference is in the responses to the statement that *A range of audit fees should be specified by the Libyan regulatory authorities that allocates audit clients to audit firms*. The level of agreement with this statement by audit firm respondents was significantly higher (3.11 mean score) than it was for oil company respondents (2.81 mean score), respectively. This result might reflect a lack of confidence within the oil companies in the Libyan regulatory authority. Another significant difference at the 1% level of significance was in relation to the statement *Audit firms in Libya should be restricted to undertaking only audit work*. The level of agreement with this statement by oil company respondents was significantly higher (3.97 mean score) than it was for audit firm respondents (3.14 mean score). This mismatch in the responses of oil company and audit firm respondents is probably due to the latter's unsurprising reluctance to have their work remit restricted to audit work only, with evidence showing that the share of revenue from the provision of auditing services has fallen, while the share of revenue from the provision of other services has increased (Abdel-Khalik, 1990; Craswell, 1999; Palmrose, 1986b).

Finally, oil company respondents were significantly higher (3.94 mean score) than audit firm respondents (3.33 mean score) in respect of the statement *The percentage of NAS income for audit firms should not be higher than 25% of total audit firm revenues generated from a single client*. This mismatch in the responses of the two sets of participants might reflect auditors' concern about the threat faced by them when depending heavily on a single client. The threat lies in whether they are able to behave independently without fear despite receiving significant revenue from the client (see for example, Flint, 1988). This finding is consistent with Firth (1980), Gul (1991), Teoh and Lim (1996), and Beattie et al (1999), who all found that the size of audit fees is an important determinant of the perception of auditor independence.

Beattie and Fearnley (2002) argue that the auditor should be prevented from becoming dependent upon one client for audit fees. At present, accounting regulations prevent any one client making up more than 10% of an auditor's income. The strong support shown by the respondents from oil companies might be a sign of their concern about the negative impact of relying on single clients. Also this finding may be due to the concerns of audit firms, who may feel that profit will be lost if they do not provide audit services,

Table 5.25: Distribution of the Evaluations given by the Different Statements Regarding the Future Development of Audit Quality in Libya

Statement	Audit Firms										Oil Companies						
	SD %	D %	NV %	A %	SA %	Mean	Median	SD %	D %	NV %	A %	SA %	Mean	Median	Sig		
Audit firms in Libya should adhere to audit quality requirements.	14.4	13.1	11.3	38.1	23.1	3.43	4.00	12.6	15	20.5	30.7	30.7	3.33	4.00			
The LAAA should adopt international auditing and accounting standards to improve audit quality and should have strict requirements for granting audit licenses.	12.5	16.3	3.8	31.3	36.3	3.63	4.00	11.8	11	6.3	40.2	30.7	3.67	4.00			
There should be legal and disciplinary actions available to the authorities against non-compliant and dishonest auditors.	8.1	20	9.4	36.9	25.6	3.52	4.00	10.2	10.2	15	35.4	29.1	3.63	4.00			
Audit firms in Libya should be restricted to undertaking only audit work.	15	19.4	21.3	25.6	18.8	3.14	3.00	7.9	6.3	10.2	32.3	43.3	3.97	4.00	*		
The current auditing rules and regulations need to be much improved.	2.5	5.6	15	52.4	24.4	3.91	4.00	11.8	7.9	11	30.7	38.6	3.76	4.00			
A range of audit fees should be specified by the Libyan regulatory authorities that allocates audit clients to audit firms	8.1	28.1	21.3	30	12.5	3.11	3.00	13.4	33.1	22	22	9.4	2.81	3.00	**		
Audit firms should disclose the type and amount of NAS provided to their audit clients and oil companies should disclose the amount of audit and NAS fees paid in the annual report.	7.5	20	22.5	25.6	24.4	3.39	3.50	1.6	17.3	25.2	33.1	22.8	3.58	4.00			
The percentage of NAS income for audit firms should not be higher than 25% of total audit firm revenue generated from a single client	16.3	20.6	3.8	32.5	26.9	3.33	4.00	7.1	7.9	4.7	44.9	35.4	3.94	4.00	*		

*, **, *** indicates distribution of responses is significantly different at the 1%, 5% levels, respectively using the Mann Whitney U test

5.5.1.1 Future Development of Audit Quality in Libya Based on Position

Table 5.26 shows the analysis by position of significant differences between oil company staff and audit firm staff opinions on ways to improve audit quality. The Kruskal-Wallis test was used and the analysis reveals two significant differences at the 5% level and three at the 1% level of significance. Accounts managers had significantly higher mean scores (3.83, 4.29 and 4.20) than others for the following two statements: *Audit firms in Libya should adhere to audit quality requirements* and *The current auditing rules and regulations need to be much improved* at the 5% level of significance. This mismatch reflects awareness of the requirements of the Libyan auditing environment, such as the need to adopt International Auditing Standards or stricter requirements for the granting of auditing licences.

A further interesting difference is in the responses to the two statements that *The percentage of NAS income for audit firms should not be higher than 25% of total audit firm revenue generated from a single client* and *Audit firms in Libya should be restricted to undertaking only audit work*. The level of agreement with these statements by account managers was significantly higher (4.20 and 4.03 mean scores respectively) than it was for the auditor, audit supervisors and managing partner respondents (3.21, 3.31, 3.48 and 2.92, 3.37, 3.13 mean scores) respectively. This finding may be due to the concerns of audit firm staff, who may feel that profit will be lost through their non-provision of audit services. Also the result might reflect accounts managers' beliefs that audit quality and audit independence will be impaired if the percentage of NAS income for audit firms becomes higher than 25% of the total audit firm revenue generated from a single client. This finding is consistent with that found by Beattie and Fearnley (2002), who argue that the auditor should be prevented

from becoming dependent upon one client for audit fees. At present accounting regulations prevent any one client making up more than 10% of an auditor's income.

Another significant difference at the 1% level of significance was found in respect of the statement *A range of audit fees should be specified by the Libyan regulatory authorities that allocates audit clients to audit firms.*, In this case, the managing partners had a significantly higher mean score (3.42) than accounts managers (2.29), an outcome that possibly reflects the willingness of the managing partner to consent to a range of audit fees being proposed by an independent body.

Table 5.26: Distribution of the Evaluations given by the Different Statements Regarding the Future Development of Audit Quality Based on Position:

Statement	Audit Firm Staff						Oil Company Staff						Sig
	Managing Partner		Audit Supervisor		Auditor		Internal Auditor		Financial Manager		Accounts Manager		
	Mean	Median	Mean	Median	Mean	Median	Mean	Median	Mean	Median	Mean	Median	
Audit firms in Libya should adhere to audit quality requirements.	3.12	4.00	3.63	4.00	3.52	4.00	2.96	3.00	3.32	4.00	3.83	4.00	**
The LAAA should adopt international auditing and accounting standards to improve audit quality and should have strict requirements for granting audit licenses.	3.44	4.00	3.90	4.00	3.54	4.00	3.44	4.00	3.70	4.00	3.91	4.00	
There should be legal and disciplinary actions available to the authorities against non-compliant and dishonest auditors.	3.62	4.00	3.60	4.00	3.36	4.00	3.47	4.00	3.55	4.00	3.94	4.00	
Audit firms in Libya should be restricted to undertaking only audit work.	3.13	3.00	3.37	4.00	2.93	3.00	3.98	4.00	3.91	4.00	4.03	4.00	*
The current auditing rules and regulations need to be much improved.	3.67	4.00	4.04	4.00	4.00	4.00	3.80	4.00	3.34	4.00	4.29	5.00	**
A range of audit fees should be specified by the Libyan regulatory authority that allocates audit clients to audit firms	3.42	4.00	3.35	3.50	2.59	2.00	3.13	3.00	2.89	3.00	2.29	2.00	*
Audit firms should disclose the type and amount of NAS provided to their audit clients and oil companies should disclose the amount of audit and NAS fees paid in the annual report.	3.63	4.00	3.29	3.00	3.27	3.50	3.42	3.00	3.66	4.00	3.69	4.00	
The percentage of NAS income for audit firms should not be higher than 25% of total audit firm revenue generated from a single client	3.48	4.00	3.31	4.00	3.21	4.00	3.87	4.00	3.81	4.00	4.20	4.00	*

*, ** indicates distribution of responses is significantly different at the 1%, 5% levels, respectively using the Kruskal-Wallis test

5.5.1.2 Future Development of Audit Quality in Libya Based on Type of Audit Firm

Table 5.27 shows the analysis of significant differences between local audit firms, local firms affiliated to an Arab or international firm, and local firms affiliated to one of the Big Four audit firms (non-Big Four and Big Four). The Kruskal-Wallis test revealed three significant differences at the 5% level.

The level of agreement for two statements, namely, *Audit firms in Libya should be restricted to undertaking only audit work* and *Audit firms should disclose the type and amount of NAS provided to their audit clients and oil companies should disclose the amount of audit and NAS fees paid in the annual report* were significantly higher for Big Four audit firm respondents (3.86 mean score) than for local and international audit firm (non-Big Four audit firm) respondents (2.96, 3.19 and 3.45, 3.05 mean scores, respectively). This result might reflect the awareness of the Big Four audit firms of insufficiencies and inadequacies in the Libyan auditing environment, and their consequent support for the establishment of rules and procedures in respect of the disclosure of the type and amount of NAS provided to clients, as is the practice in developed countries. The Big Four audit firms, therefore, appear to be keener than non-Big Four respondents for the type and amount of NAS fees provided to the client to be disclosed, thereby implying that the Big Four audit firms are in favour of the provision of NAS only if their type and amount paid are fully disclosed in annual reports. This finding is consistent with that of Lennox (1999b) who concluded that when NAS fees are disclosed, the provision of NAS does not reduce audit quality.

Table 5.27 shows one significant difference at the 5% level of significance in respect of the statement *A range of audit fees should be specified by the Libyan regulatory authorities that allocates audit clients to audit firms*. This was significantly lower for Big Four respondents (2.48 mean score) than it was for local, Arab, and international audit firm (non-Big Four) respondents (3.07 and 3.26 mean score). This outcome does not coincide with the view that non-Big Four audit firms are seen to provide lower audit quality than Big Four audit firms. Non-Big Four audit firm respondents, therefore, appear to support strict requirements for granting audit licences in order to improve the existing level of audit quality. The responses from the non-Big Four and Big Four audit firm respondents were to the effect that they received insufficient fees to perform a higher standard of audit quality, thus supporting the establishment of an independent body to specify audit fees in order to eliminate differences that presently exist.

Table 5.27: Distribution of the Evaluations given by the Different Statements Regarding the Future Development of Audit Quality Based on Type of Audit Firm

Statement	Local Audit Firm		International Audit Firm		Big Four Audit Firm		Sig
	Mean	Median	Mean	Median	Mean	Median	
Audit firms in Libya should adhere to audit quality requirements.	3.22	3.00	2.81	3.00	2.57	2.00	
The LAAA should adopt international auditing and accounting standards to improve audit quality and should have strict requirements for granting audit licenses	3.41	4.00	3.95	4.00	3.95	4.00	
There should be legal and disciplinary actions available to the authorities against non-compliant and dishonest auditors.	3.57	4.00	3.56	4.00	3.19	4.00	
Audit firms in Libya should be restricted to undertaking only audit work.	2.96	3.00	3.19	3.00	3.86	4.00	**
The current auditing rules and regulations need to be much improved.	3.98	4.00	3.67	4.00	4.05	4.00	
A range of audit fees should be specified by the Libyan regulatory authority that allocates audit clients to audit firms.	3.26	3.00	3.07	3.00	2.48	2.00	**
Audit firms should disclose the type and amount of NAS provided to their audit clients and oil companies should disclose the amount of audit and NAS fees paid in the annual report.	3.45	4.00	3.05	3.00	3.86	4.00	**
The percentage of NAS income for audit firms should not be higher than 25% of total audit firm revenue is generated from a single client.	3.55	4.00	2.93	3.00	3.14	4.00	

*,** indicates distribution of responses is significantly different at the 1%, 5% levels, respectively using the Kruskal-Wallis test

5.6 Summary

This chapter has presented the results of the questionnaire survey undertaken with representatives from oil companies and audit firms operating in Libya. In discussing these results, the analysis began with descriptive statistics in respect of the different participants in the research sample. Variations in the patterns of difference in the responses according to background characteristics, such as (1) position of respondents, and (2) type of audit firm, were identified by subjecting the data to the Mann Whitney U test and the Kruskal Wallis which allowed for a comparison of sample means and the detection of statistically significant differences. Without doubt, the respondents from both the oil companies and the audit firms considered the current level of audit quality in Libya to be unsatisfactory, both groups of respondents the Libyan Accountants and Auditors Association (LAAA) were considered to be not performing an important role in either developing the auditing profession or enhancing audit quality.

As with other research in this area of work, an attempt was made to measure audit quality through the adoption of different variables as surrogates for this construct, namely: size of the audit firm, the provision of NAS, the length of auditor tenure, the level of competition in the audit market, and the fees charged/received for audit services. The examination of the perception of the relationship between firm size and audit quality, revealed that both respondent groups (oil companies and audit firms), perceived the Big Four audit firms as offering a higher level of audit quality than others, for the following main reasons:

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As with other research in this area of work, an attempt was made to measure audit quality through the adoption of different variables as surrogates for this construct, namely: size of the audit firm, the provision of NAS, the length of auditor tenure, the level of competition in the audit market, and the fees charged/received for audit services. The examination of the perception of the relationship between firm size and audit quality, revealed that both respondent groups (oil companies and audit firms), perceived the Big Four audit firms as offering a higher level of audit quality than others, for the following main reasons:

- 1- The Big Four firms have greater independence than smaller firms and are more likely to issue qualified reports.
- 2- The Big Four firms can report the real financial situation of their clients more readily than other firms as they do not need to please managements.
- 3- The Big Four firms perform more powerful, effective tests and are more likely to detect errors, thereby giving them more credibility than other firms.
- 4- The Big Four firms can plan the audit process more effectively and can obtain a greater variety of clients.

With regard to perceptions of the relationship between the provision of NAS and audit quality, both respondent groups, oil companies and audit firms, perceived that the provision of NAS would not impair the level of audit quality; rather, it was envisaged that this would provide auditors with better access to clients' accounting systems, and hence greater familiarity and confidence with them. Although both groups of respondents perceived that prohibition of the provision of NAS to an audit client was simply a vehicle to maintain the perception of auditor independence, they did nonetheless, believe that providing NAS by a separate department was a sensible strategy as this was perceived by both groups as giving the auditor greater credibility.

Regarding perceptions of the relationship between the length of audit tenure and audit quality, both respondent groups believed that long tenure with a client would lead to fewer audit hours by an auditor. More specifically, the respondents from both groups perceived mandatory rotation to be advantageous as a means to enhancing the level of audit quality.

With regard to the perceptions of the relationship between the level of competition in the audit market and audit quality, both respondent groups agreed that the highly competitive nature of the Libyan audit market should not adversely affect audit quality. They also believed that audit quality would not be negatively affected in the event of audit fee discounting or low-balling at initial engagement.

When examining perceptions of the relationship between the fees charged/received for audit services and audit quality, both oil company and audit firm respondents perceived a positive relationship between the amount of audit fees paid and the level of audit quality provided by external auditors. An audit firm that charges high audit fees is most likely to provide high audit quality. Interestingly, the Big Four were perceived to charge higher audit fees, in recognition of the large premium attached to their services. It was also suggested that if audit fees were to be set by an independent professional body this might lead to higher audit quality, a suggestion supported by local audit firms which claim they do not provide a higher level of audit quality because they do not receive the same high level of fees as foreign audit firms.

In an attempt to elicit respondents' perceptions on how to improve audit quality in Libya in the future, respondents from the two populations were asked to express the extent of their agreement with statements suggesting ways to improve the level of audit quality in the country. Both groups of respondents believed in the need for substantial improvement to the current auditing rules and regulations. The LAAA was considered to perform a vital role in its adoption of international auditing and accounting standards to improve audit

quality and it was also believed that it should impose strict requirements in respect of the granting of audit licenses. Interestingly, oil companies and audit firms were in agreement with the idea of new legislation to oblige oil companies to disclose the amount of audit and NAS fees paid in their annual reports, and to require audit firms to disclose the type and amount of NAS provided to their audit clients. However, it was not believed to be necessary to restrict audit firms to undertake audit work only in an effort to improve audit quality.

Overall, the findings supported those reported by other researchers, such as Michael (2007), Sandra et al (2007), DeAngelo (1981a), Krishnan (2003), Jackson et al (2008), Craswell (1999), DeFond et al (2002), Chen et al (2008), and Vanstraelen (2000). In Chapter Six that follows, the interview survey that was undertaken as part of the empirical research will be discussed in order to provide further understanding, support and confirmation in respect of the results obtained from the questionnaire survey.

CHAPTER SIX

QUALITATIVE FINDINGS

6.1 Introduction

The research findings from the questionnaire administered in Libya indicate that the issues related to audit quality investigated in this study have been generally perceived by the respondents from audit firms and oil companies as having a significant impact on audit quality. In an attempt to explore some of these issues further, a series of interviews were undertaken with Libyan oil companies (internal auditors, financial managers and accounts managers) and employees from audit firms working in Libya (managing partners, audit supervisors and auditors) and senior managers of regulatory authorities. Details of the schedule of interviews are provided in Table 6.1. The main objective of the interview survey was to analyse the issues raised by the results of the questionnaire survey in more depth. This chapter includes the objectives of the interviews, the key outcomes of the interviews and the profile of the interviewees. The main part of the chapter reports on the effects of each of the five factors identified in the key outcomes of the interviews (section 6.4.2).

6.2 Objectives of Interviews

Interviews were conducted in order to approach issues that could not be captured properly or analysed through a quantitative approach. The major purpose of conducting qualitative research is to understand and gain insight into the researched phenomena (Collis and Hussey, 2003; Sekaran, 2003;

Saunders et al, 2007). The total number of interviews conducted with the oil companies staff was ten; three with internal auditors, four with financial managers, and three with accounts managers, and the total number of interviews, conducted with the audit firms staff working in Libya, was thirteen; four with managing partners, six with audit supervisors, and three with auditors. Finally, two interviews were conducted with regulators working for the LAAA. Officials at the Libyan oil companies and audit firms are represented in the sample of interviewees as they were expected to provide information in a private meeting and explain further issues related to the significance of information concerning the current perception of audit quality and the audit quality variables in Libya such as firm size, the provision of NAS, the length of audit tenure, the level of competition in the audit market, and fees for audit services. Interviews are considered as an effective means of collecting large amounts of data, and were, thus believed to be appropriate to offer guidance regarding fruitful interpretations of the quantitative study, and extensions of the research findings (Leventis, 2001).

6.3 Key Outcomes from the Interviews

Interviewees explained that several factors affected the audit quality, citing firm size, the provision NAS, the length of audit tenure, the level of competition in the audit market, and fees charged and received for audit services. Recognising these influences upon the overall quality of the audit exercise, the vast majority of interviewees were not satisfied with the current level of audit quality in Libya, and they indicated their dissatisfaction with the role played by the LAAA in its efforts to enhance the level of audit quality.

The majority of interviewees supported the notion that higher audit quality is associated with local audit firms affiliated to foreign audit firms, especially those affiliated to one of the Big Four, rather than being associated with ordinary local audit firms. The reasons given were quite simply that the foreign, (especially Big Four), audit firms are better resourced than local firms and have accumulated more experience. With regard to the provision of NAS, most interviewees referred to its benefits as they accrued to both auditors and clients. They considered that lengthy auditor tenure with a client might impair audit quality and that mandatory auditor rotation was expected to improve audit quality. On the theme of competition, the interviewees were of the opinion that the Libyan audit market is highly competitive, but that audit quality would not be threatened by this. They did consider that the audit fee is positively associated with audit quality. In other areas, the interviewees confirmed that the LAAA should adopt professional auditing and accounting standards to improve the audit quality. Details of the interviewees, and the positions held by them in their organisations are shown in Table 6.1.

6.4 Interview Results

This section explores, in detail, the perceptions of the interviewees concerning the various levels outlined above. The interviewees' responses are discussed under the headings of audit quality in Libya.

6.4.1 Demographic Information Relating to Interviewees

Table 6.1: The Interview Schedule at the Libyan Oil Companies and Audit Firms

Interviewee Date	Position	Organisation	Number of Interviews
12-05-2008	Internal auditors	Oil company	3
28-05-2008	Accounts managers	Oil company	3
16-06-2008	Financial managers	Oil company	4
24-06-2008	Managing partners	Audit Firm (Tripoli)	4
2-07-2008	Auditors	Audit Firm (Bengasi)	3
21-07-2008	Audit supervisors	Audit Firm (Tripoli)	6
21-07-2008	Regulators	LAAA	2
TOTAL			25

The interviews conducted with accounts managers, internal auditors and financial managers in Libyan companies, and with managing partners, auditors and audit supervisors in audit firms working in Libya were analysed and discussed.

Table 6.2: The Experience Levels of Interviewees

Experience	Frequency	Percentage
Less than 5 years	-	-
5-10 years	7	28
More than 10 years	18	72
Total	25	100

In terms of the length of work experience of respondents, as shown in Table 6.2, three respondents (72%) had more than 10 years. Of these, two respondents (28%) had between 5 to 10 years experience, and no interviewee

had less than 5 years work experience. This was encouraging since it provided a sample that was genuinely equipped to reflect on the quality of audit

6.4.2 The Current Perception of Audit Quality in Libya

According to DeAngelo (1981), audit quality depends on the ability of the auditor to carry out a thorough examination of the accounts and detect possible errors or anomalies (technical competence), and his or her willingness to provide an objective opinion on them (his or her independence). Concerns about audit quality are relevant for economies in transition, as is the case for Libya. With the movement of many international accounting firms into Libya, and the growth of local audit firms, it is particularly interesting, and relevant for governmental legislators, to study how the providers of the audit service perceive the quality of what they do. The purpose of this section is to report the perceptions of professional auditors in Libya concerning how they perceive the quality of the service they provide. The section also analyses differences between the perceptions of audit firm staff and oil company staff.

The questionnaire survey findings presented in Chapter Five, section 5.3, revealed that 68.5% of oil company respondents and 56.3% of audit firm respondents either agreed or strongly agreed with the statement: *The current level of audit quality in Libya is insufficient*. Whilst there was a disparity between the two groups, more than half of both populations were, nonetheless, of the opinion that there needed to be improvements in audit quality. 96% these interviewees thought the current level of audit quality was insufficient, the interviewees referred to reasons such as this could be due to the perceived lack of auditors' professionalism in Libya, since 51.9% and 43.8% of respondents

of oil companies and audit firms either agreed or strongly agreed with the statement that the lack of the professionalism of auditors in Libya causes the low level of audit quality. Another interesting finding is that just over half of the respondents (62.2% and 56.9%) either agreed or strongly agreed with the statement that most audit firms in Libya have little idea about new services, such as assurance services and internet reporting.

Additionally, the current rules and regulations are perceived to be weak, thereby causing poor audit quality. In this respect, 59% and 61.3% of oil company and audit firm respondents respectively believed these to be insufficiently comprehensive, and that the LAAA is not performing its role either in enhancing audit quality or in developing the accounting and auditing profession. On this matter, an audit supervisor in a local firm affiliated to an Arab audit firm said:

In my opinion, there are several reasons that have made the level of audit quality in Libya insufficient, such as the lack of professionalism of auditors and the lack of strict penalties for violators of the rules of audit profession ... In my view, I worked in the audit market for more than 31 years, I have never heard of any actions against undisciplined auditors.

This opinion was confirmed by a managing partner in a local audit firm who remarked:

I believe that the current level of audit quality insufficient can be referred to reasons such as weakness in the current rules and regulations in terms of the absence of punitive fines and the accounting and auditing education system in Libya are still insufficient to train auditors.

Likewise, a financial manager in one of the oil companies stated:

I think the lack of the role of the LAAA could be a cause of the level of audit quality being insufficient, because the LAAA has

never done anything which could be identified as real to develop the auditing profession and to enhance audit quality.

The issue of staff qualification was also raised by a managing partner in one of the Big Four audit firms, who commented:

I believe that the level of audit quality is insufficient due to several reasons such as the absence of qualified and specialised staff and the shortage of professional and qualified accountants, and the absence of proper related laws that could support the LAAA in conducting its roles, and also most audit firms in Libya have no idea about new services, they are still audited using traditional methods.

The ineffectiveness of the LAAA was also observed by an auditor in local audit firm who added:

The LAAA should have adopted either American or International standards, and focused on how to improve the professionalism of accounting and auditing practitioners and on quality, from the beginning, ignoring this has contributed to the low level of audit quality.

All of the interviewees (100%) criticised the LAAA for not classifying audit firms on the basis of number of employees, revenue, resources, and for not formulating any principles or standards of accounting or auditing, which has resulted in the lack of any theoretical basis for a Code of Ethics to which members of the profession must conform. Clearly, in the absence of such action on the part of the LAAA, it is entirely logical that the American principles and standards have been followed.

This failure of the LAAA, despite being established more than three decades ago, to build any theoretical base for accounting as a profession in Libya, is raised not only by the interviewees in this study, but has been highlighted by many researchers who have confirmed the LAAA's failure to develop either accounting and auditing standards or a Code of Ethics to guide auditors'

behaviour, and its adoption of a very limited role in the area of research, and professional control over accounting practices (Bakar and Russell 2003; Mahmud, 1997; Kilani, 1988; Ahmed, 2004). This suggests that the LAAA has failed to regulate itself and to recognise its obligation towards the public interest. Furthermore, it has not achieved its objectives of furthering activities such as research, conferences, seminars, and generally promoting a programme of continuing education and training, which would include the publication of accounting research, all of which would improve the status of the profession and accordingly of its members. All these factors suggest that the status of the Libyan accounting profession is very weak. The LAAA specifies no uniform audit report requirements and no professional examination requirements. The main reasons for its limited role and, hence, impact, are as Mousa (2005) suggested, its small size and restricted authority.

One of the regulators who was interviewed commented on the LAAA's failure to achieve its objectives, saying:

It is my view that the LAAA since establishment more than three decades ago is just the issue of new licences and taking fees from the members for their membership. Furthermore, it has not achieved its objectives of furthering activities such as research, conferences, and seminars, a continuing education.

And an accounts manager in an oil company also referred to the length of time that the LAAA had had to organise the profession, saying:

In my view, the level of audit quality is insufficient, even though the LAAA has been in existence now for almost three decade; some of the reasons identified include the lack of supervision by the LAAA, the lack of strong penalties and the lack of sufficient rules and regulations.

This view was echoed by a managing partner in local firm affiliated to an Arab audit firm who remarked:

I don't think that the LAAA is playing an important role in developing the profession of auditing and enhancing audit quality. This is because they are not classifying audit firms on the basis of number of employees, revenue, resources, and number of clients, in order to help the clients decide which audit firms are most suitable for them, and this stresses again its failure to give attention to small (local) audit firms.

Its failure to impose a strict regulatory framework was also commented on by an accounts manager who added:

In my view the LAAA haven't imposed strict conditions on each applicant for a license to practice the profession which reflects the lack of the professionalism of auditors and low audit quality.

In conclusion, it can be said that the profession itself perceives its own work to be of poor quality, and that those involved attribute this lack of quality to be the result of an ineffective regulatory framework, which should be provided by the LAAA. Because of the inaction of the LAAA there is no development of the profession, in all its dimensions, and auditors are left to their own devices with no threat of punishment for poor performance.

6.4.3 Factors Impairing and Enhancing Audit Quality

In this thesis, five research themes relating to audit quality that became increasingly obvious within the Libya environment, and hence of concern, are explored, these being: the size of audit firm, the provision of NAS, the length of audit tenure, the level of competition, and fees for audit services. Briefly, the interview survey findings are consistent with the questionnaire survey on all of these issues and are presented in the subsequent sections.

6.4.3.1 The Size of Audit Firm and Audit Quality

Audit firm size has been used as a surrogate for audit quality in prior literature (e.g. DeAngelo, 1981a). Moreover, prior research (e.g. Becker et al, 1998; Francis et al, 1999) has reported that Big Four audit clients present lower discretionary accruals than those of non-Big Four firms because Big Four auditors may have more expertise, resistance to clients' discretion, and awareness of financial and reputation loss, than non-Big Four auditors. Therefore, this section aims to demonstrate whether the size of the audit firm affects audit quality in Libya, and to identify reasons for possible quality difference by firm size.

The majority of interviewees (88% of oil companies and audit firms) agreed that the size of audit firms does indicate different levels of audit quality, and that they believe the Big Four audit firms to be more powerful, effective and independent than the non-Big Four firms. This finding confirms the questionnaire responses (see Chapter Five) which showed that 69.3% of oil companies, and 61.9% of audit firms agreed that the Big Four firms perform more powerful and effective tests, and are consequently, more credible than other firms.

More than three-quarters of the interviewees (76%) believed that the level of audit quality in Libya depends upon the status of the audit firm, e.g. local audit firm affiliated to a foreign audit firm, and again, this confirmed the questionnaire survey results, which showed that more than half of the oil company and audit firm respondents (66.9% and 59.4 %, respectively) similarly agreed this was the case.

Consistent with the literature (GAO, 2003a; Mautz and Sharaf, 1961), the interviewees believed the Big Four firms to benefit from greater organisational structure and resources than smaller audit firms. Examples were cited of dedicated resources for staff training, and technical support, and the fact that this favourable resource base placed the Big Four firms favourably in the employment market, being more attractive to better qualified personnel. Undoubtedly, the quality of service is dependent upon the quality of those providing it, and hence the audit process is improved by well-qualified personnel, since they are motivated by their professionalism to comply with accounting standards and codes of ethics and not to ignore irregularities in clients' accounts. This result confirms the questionnaire finding (see Chapter Five) that 66.1% of oil companies and 62.8% of audit firms believed that the Big Four firms are more likely to issue qualified reports and to plan the audit process more effectively, thereby obtaining a greater variety of clients, and in consequence, being able to provide their audit staff with greater experience.

Furthermore, the issue of job security was raised by the interviewees, who believed that the ability of the Big Four firms to provide this served to instill confidence in staff regarding their work and in reporting their findings. In this situation, management pressure from the client firm is easier to resist.

On this issue an auditor in one of the Big Four audit firms remarked:

If it is a Big Four firm, I would have more confidence. There is a greater spread of expertise and there is less likely to be an independence problem whereas with a smaller audit firm, they may be more dependent on one audit.

This result confirms the questionnaire finding in respect of the statement *The companies audited by the Big Four are more attractive to investors and creditors* which had a high mean score (3.77 and 3.78), resulting from 63.8% and 68.1% of oil company and audit firm respondents agreeing or strongly agreeing with it. This result might also explain why Big Four auditors have been reported as providing higher quality auditing than non-Big Four auditors in prior literature (e.g. Becker et al, 1998; Francis et al, 1999; Francis and Krishnan, 1999; Teoh and Wong, 1993; Al Mogbel, 2006).

On this issue of the external perception of audit firm size, a financial manager in an oil company remarked:

There is a greater opportunity to influence a smaller practice than a larger practice because the latter is very well organised and has its own structures in place. A small firm won't have the same resources and will depend on individuals within the practice to try and bring the same checks and balances which a large firm, by having the structures in place, can automatically impose.

As Big Four audit firms have many audit clients, they might not be economically dependent on just a few of them. In addition, large firms have more wealth to pay larger potential claims if sued, than smaller firms (Simunic and Stein, 1996) and so, might be more concerned about maintaining audit quality and their reputation in the audit market than smaller firms. In addition, large size companies with good accounting systems and less earnings manipulation might possibly hire Big Four auditors because they might be concerned about the quality of their financial statement quality and the reputation of their companies. Therefore, they might select Big Four audit firms to signal a positive company image to the public (Chung et al, 2003).

An accounts manager in an oil company remarked:

I wouldn't necessarily be comfortable that the smaller audit firms would have the procedures or methodologies that the Big Four would have.

This overall perception of enhanced professionalism in respect of the Big Four firms filtered through to comments about staff training, since it was noted by the participants that these firms were financially equipped to ensure their staff were properly trained in all the appropriate areas. Moreover, it was noted that they encouraged their staff to gain additional professional qualifications, providing study leave under the 'article-ship' scheme. This is a bonus that many small and medium-sized firms are simply unable to underwrite since they cannot afford to lose their staff for any length of time. The Big Four in contrast, are sufficiently geared up and financed to be able to offer flexibility such that staff can attend classes and examinations. The outcome seemed to be that Big Four staff show more loyalty to their employers and are less willing to compromise their employers' reputations by surrendering to client pressure, than their counterparts from local audit companies. And, because of their training opportunities, the Big Four auditors are more skilled and effective in their diagnosis of activities that are inconsistent with clients' going-concern status, so there is a clear perception that staff from these organisations are more professional in their activities than staff from smaller firms.

An internal auditor in one of the oil companies raised the issue of greater objectivity, saying:

The Big Four are part of international groups which are obliged to satisfy international standards. The smaller firms don't have such ties, reporting structures or quality standards.

The Big Four are less likely to give a personalised approach to their clients.

It was considered by a great majority of participants (84% overall) that international reputation, and hence their well-understood brands, was the reason why foreign audit firms believed their audit quality to be better than local companies. Indeed the international reputation was an important variable for these interviewees who noted that the large majority of oil companies continued to engage the Big Four firms as their auditors, on the grounds that their financial reporting is believed to be consistent with global standards. In fact, some of the companies that operate internationally associate themselves with reputable auditors in order to facilitate their dealings with foreign investors and companies. It was quite apparent from the interviewees' comments that their foreign associates always judged the credibility of their financial statements by reference to the auditor's name.

The importance of the auditor being known to be credible was raised by a managing partner in one of the Big Four audit firms who commented:

In the bigger audit firms you would find a huge diversity of clients whereas in the smaller audit firms, you may find that the auditor is a close friend of the company.

According to a Big Four managing partner:

The Big Four firms' auditors are able to maintain a higher level of audit quality, possibly due to their organisational structure, technology and competency.

It was also mentioned by participants that in comparison to their counterparts in small firms, the Big Four firms have larger customer portfolios, and consequently they are not reliant upon any single customer. This places them

well in terms of being able to resist management pressure and more able to report any negative findings. In contrast, small audit firms are limited in their customer base as pointed out by Pearson (1980a), and the termination of any audit job could affect their financial standing. Not surprisingly, the temptation is there to compromise with clients in order to keep their custom.

In respect of the size of customer portfolio, one audit supervisor from a Big Four firm noted:

The Big Four can afford to lose customers, are more flexible and more powerful than small firms, and they want to keep the major companies such as oil companies.

On the other hand, a small minority of the interviewees disagreed that audit quality differs according to the size of audit firms. These participants believed this to be a misconception that comes from the clients' management, as a result of clients attempting to boost their reporting image by associating with audit firms that have a good reputation. It may be the case that the management does not have confidence in the company's reporting practices, and tries to find an easy way to divert the audience's attention by employing an international audit firm. It was pointed out that the differentiation is only to meet the consumers' requirements. The small firms' ability is in question simply because they are not being tested. Commenting on the difference between the Big Four and non-Big Four firms, an auditor of a local audit firm believed that the quality of Big Four and non-Big Four auditors in Libya did not significantly differ because it depended on individual competence and attitude rather than firm size. He said:

In my opinion, the quality of Big Four and non-Big Four auditors in Libya does not differ since I believe that their quality depends on individual competence and attitude. Size

does not matter. However, auditors in Big Four firms have advantages from international working systems and quality control, so people may have stereotyped image of Big Four quality without considering individual competency.

However, a chief internal auditor from a large oil company disagreed with this view, arguing that:

The quality of Big Four and non-Big Four auditors differs because Big Four firms have more hi-tech resources. They hire competent staff and provide them with good training courses in order to render good services to their clients. Moreover, audit clients come from different groups. Big Four clients are large listed companies with higher audit fees whereas non-Big Four clients are small or medium size companies with lower fees. These differences contribute to differences in audit quality.

Considering all the responses from the interviewees, it seems obvious that the Big Four audit firms have more resources at their disposal, and are able to offer better on-going training to their staff. This appears to be understood in the marketplace and associated with a better quality service, as also is the non-reliance on clients to the same extent that smaller firms who have less of a reputation are compelled to do. Hence, audit quality might well differ by size of audit firm.

6.4.3.2 Provision of NAS and Audit Quality

The majority of interviewees did not perceive any reduction in the audit quality where NAS was provided. Indeed, they confirmed that they would have recommended their clients to use their firms for such services, arguing that the audit firm's experience and knowledge of their businesses would result in better advice being obtained. Other interviewees argued that they would prefer to see audit firms provide NAS to their clients because it would ensure that the

standard applied to the audit would be higher and that a better audit opinion would result. On this issue, a Big Four managing partner remarked:

Sometimes, yes, we suggest to clients that they come to us for NAS because accountants are the best people to provide these services because they already know that company's history and business ... and by providing NAS as well, the auditor learns more about the client and can give more informed advice.

The questionnaire survey findings presented in Chapter Five, section 5.4.2, revealed that only a minority of oil company (23.7%) and audit firm (16.9%) respondents either agreed or strongly agreed with the statement: *The provision of NAS impairs audit quality.* Similarly, most oil companies and audit firms (72%) disagreed that audit quality would be impaired if the auditor were to provide NAS to audit clients, and pointed out that both parties would benefit from the arrangement. It was indicated that the provision of NAS would complement audit duties, as the auditor would be exposed to the audit client's business transactions and subsequently gain a better understanding of the client's overall enterprise.

An audit supervisor in a local audit firm affiliated to an Arab audit firm summarised the view by saying:

If you can gain more information about your client, you can give a better audit opinion. Your appreciation of the client's business is greater so you can consider all the factors, and then provide a better service.

Moreover, a Big Four auditor commented:

An audit could be of a higher standard overall because the auditor is also providing NAS. In this case the auditor would not want to lose the client by not giving good quality all-round service so the audit might be of an even higher standard ... but actually, the auditor knows the company better than other

consultants, and it is true that the company would want someone who did know their business and their systems ... they wouldn't have to spend a long time learning everything about the company because they already have all the background.

Another local audit supervisor added:

I don't see anything that makes me be concerned that the audit is not independent. In fact, the auditor is in the best place to understand the client's business and its financial operations.

A small minority of oil companies and audit firms (28%) interviewed did, however, believe that audit quality would be impaired by the joint provision of audit and NAS to audit clients. Their argument was that auditors would build close relationships with their clients with the aim of securing other business opportunities and may use audit services as a 'loss leader' to leverage the audit services into other consulting engagements. This belief was well summarised by an internal auditor of one of the oil companies, who argued that:

Not all the NAS can impair auditors' independence, as there are some certain types that can impair it and others would not. For instance, if the service provided is not related to decision making, independence would not be an issue.

Because the majority of interviewees had a positive attitude towards the provision of NAS by audit firms, it led to a discussion on the manner in which they perceived that such services were provided by audit firms. In all cases, they had assumed that both roles were performed by separate departments. A number of them stressed the importance of such separation as a means of ensuring that the audit quality was not compromised. The vast majority of oil companies and audit firms (96%) interviewed agreed that audit quality and auditor independence would not be threatened if the provision of audit and NAS to an audit client was performed by staff from different departments, a

perception that is consistent with the results from the questionnaire survey (Chapter Five, section 5.4.2). The phenomenon known as the 'Chinese Wall' (Mikol and Standish, 1998; Sori, 2005) was discussed, whereby the segregation of duties allows for NAS to be provided with confidence by personnel totally uninvolved with the audit. The interviewees believed that greater monitoring would occur in this situation, with different personnel handling different matters, and that this monitoring in itself would ensure a professional job.

On this issue, one of the auditors in one a Big Four firm remarked:

I would be worried if NAS and audit services were being provided by the same department because this is too close, and not good for the auditor's independence, but I think this does not happen. Different departments offer these services.

The importance of the demarcation of functions was also confirmed by a managing partner of local audit firm, who remarked:

I would see the separation of functions as very important and not prejudicing their independence ... You would assume that the audit firm is very rigorous in the separation of the two roles. You would have to have an independent person performing the audit, one separate from the person who recommended the system.

However, an audit supervisor from one of Big Four firms stressed the reality of the situation, saying:

In the smaller firms, separation can not happen and the auditor is less reliable as a consequence ... In the larger firms, they are more specialised but in the smaller firms, you have the auditors providing a lot of tax expertise and then that is audited by them. I think that is where you have the least independence.

It was also mentioned by some participants that the provision of NAS by other departments in the audit firm would facilitate the exchange of information which can be difficult, and not always achieved, in instances where NAS are

provided by other companies. The idea is that those personnel with a sound appreciation of a client's business would be used to full advantage, helping to accelerate the process and thereby producing high quality financial statements.

In summary, it can be seen that the general consensus of opinion among interviewees was that the provision of NAS alongside audit services was only a serious threat to audit quality and independence where the two types of service were performed by the same department. However, the minority who disagreed with this perspective, believed that some types of NAS, especially those including decision-making, impaired audit quality and independence. Nonetheless, this result is not consistent with that of Shockley (1981) as his findings did not support the need for a separation of the consulting and audit function.

6.4.3.3 Length of Auditor Tenure and Audit Quality

The Questionnaire survey findings reported in Chapter Five (section 5.4.3) revealed that *Long tenure with a client impairs auditor independence* and that *Mandatory rotation is positively associated with audit quality*. Oil company respondents (69.3% and 63%) and audit firm respondents (72.5% and 55.3%) either agreed or strongly agreed with these statements. The majority of interviewees from both the oil companies and audit firms (80%) believed that lengthy auditor tenure with a client might impair audit quality and that mandatory auditor rotation would improve audit quality. The regulator commented on this issue, saying:

In my view, length of auditor tenure with an audit client may affect audit quality since auditors may overlook irregularity or

ignore some audit procedures since they may believe they already know everything in the client's company.

He believed mandatory rotation to be positively associated with audit quality, adding:

The idea [auditor rotation] is very good because, in my opinion, it would preserve the auditor's independence and would also keep up the quality of the audit work. However, in my opinion too, having the auditor rotated after a period of five years would be reasonable rather than a three year period in terms of gaining familiarity of the client's business which would decrease the time needed for the audit.

And a managing partner of a local audit firm identified another advantage when he commented:

I think mandatory rotation is sensible because it gives the opportunity for other auditors to look at the company from a different angle and help to correct some mistakes that the previous auditor did not address. In fact, if a strong personal relationship with the client starts to occur, mandatory rotation would break such a cosy relationship.

A Big Four auditor outlined the advantages and disadvantages associated with long auditor tenure as follows:

I think lengthy auditor tenure is like two sides of a sword. On the one hand, auditors can gain an understanding of these clients' businesses which is very crucial for identifying the risk area and their audit will become more effective and efficient. On the other hand, auditors may ignore a minor mistake that may be part of a major scandal due to their 'routine perceptions'. Moreover, auditors may be too close to their clients and they may compromise their independence unintentionally.

When asked about the impact of lengthy audit tenure on auditor independence, the interviewees gave mixed responses. The regulator remarked:

Long tenure would impact on independence, more from the point of view of the cosy relationship, people get complacent.

Moreover, a Big Four managing partner added:

Long tenure would result in the auditor beginning to think in the same way about the business. So there would be a lack of independence in thought which would build up from people developing similar ways of thinking about things ... I would think that the auditors would become very cosy in such relationships and too trusting of management.

A minority of oil company and audit firm interviewees (20%) did, however, see no connection between lengthy audit tenure and independence, one accounts manager stating:

I think that there is an actual benefit from long tenure. The practice has built up knowledge about the company itself, the management, its style. If somebody wants to fool the auditor, I would have thought that this is possible where somebody knows very little about the company ... Long-standing relationships often mean that the understanding of the business is far greater and, therefore, a better audit can be done.

Hence, independence, as well as quality, was identified as being potentially impaired in consequence of long audit tenure. Clearly, the longer the tenure, the greater the chance for strong relationships to develop between auditor and client, and threats to independence are not surprising. Being too close to the a client stands as a clear threat to auditor independence because it reduces professional detachment and objectivity through relationships that are too cosy, and through continued and unchallenged, personal trust (Hudaib, 2003). Moreover, such closeness may also influence the mental attitude and opinion of auditors and that may cause others to perceive them as not being independent (Flint, 1988). Furthermore, Flint (1988) argues that when an auditor-client relationship lengthens, both parties become more familiar with each other and an emotional relationship in addition to strong loyalty may develop between them. Such bonds may weaken the auditor's professional objectivity, audit integrity, and, thus, impair his/her independence.

Consequently, mandatory rotation of auditors has been adopted in several countries as a means of reducing threats to auditor independence arising from long-term relationships between auditors and their clients. Under mandatory rotation, auditors have a limited time horizon in which to develop relationships that could potentially cause their independence to be impaired. Hence, they could have stronger incentives for unbiased reporting (Dopuch et al, 2001).

Nonetheless, a short tenure may be equally problematic in terms of excessive switching costs and higher audit risk. This is because auditors may lack familiarity with the client's business in the first and second year of auditing, which may affect audit quality. Moreover, auditors incur high set up costs each time they change to a new client. Objections to mandatory rotation also appear in a General Accounting Office (GAO) publication that studied various issues related to auditor independence. The GAO concluded that the benefits from imposing mandatory rotation of auditors after a set number of periods were insufficient to cover switching and other costs that would be incurred by audit firms and their clients (GAO, 1996, cited in Dopuch et al, 2001). Moreover, Hudaib (2003) found in his study, that all Saudi auditors of Big and non-Big audit firms rejected the idea of rotation on the grounds that lengthy audit tenure did not represent a threat to auditor.

However, summarising the data from this study, it can be concluded that oil company and audit firm staff in Libya do believe in the concept and importance of mandatory rotation which they consider to bring benefits to the audit function, especially that of maintaining auditor independence.

6.4.3.4 The Level of Competition in the Audit Market and Audit Quality

The Libyan audit market was considered to be small and highly competitive by the majority of the interviewees (76%) of oil companies and audit firms, but they nonetheless indicated their belief that this would have no detrimental effect upon audit quality. These beliefs confirmed the questionnaire findings (Chapter Five, section 5.4.4) obtained from both oil company and audit firm respondents, 26% and 25% of whom respectively, either agreed or strongly agreed with the statement *Audit quality may be impacted if the audit firm operates in a highly competitive environment*. Hence, the majority believed that audit quality was not threatened by the high level of competition found among audit firms in Libya. The interview findings also concur with the results obtained by Copley and Doucet (1993b) who found that entities receiving a greater numbers of bids for their audit engagements were significantly more likely to receive an audit of acceptable quality. In addition, competition was found to have a negative effect on the level of audit fees, but not audit quality. Canning and Gwilliam (1999) researching in the Irish audit market, found that the small size of the market, and the closeness within it, served to enhance rather than diminish audit independence. In fact, it was revealed by the interviewees that currently about 500 audit firms were operating in the Libyan market. They indicated that the main players were firmly established and that they (the Big Four, and some medium-sized firms) presented a barrier to entry as far as the new smaller companies were concerned. The interviewees did not believe that negative competition within the market was a threat to the

profession, arguing such competition to be insignificant and as having no influence on the profession.

Remarking on this possibility, one of the regulators said:

In my opinion, competition in the audit market among audit firms will increase audit quality by forcing audit firms to try to provide good services and provide other services such as non-audit services to attract clients.

Moreover, a local firm auditor commented:

In my view, I worked in the audit market for more than 26 years, before was no any competition in Libya's audit market and this caused poor quality. This is because the clients just need any one to audit their companies and the choice was limited but now there are around 500 audit firms in the market and different type of audit firm such as the Big Four, medium size and small size.

Without doubt, the belief that the Big Four firms played a key role in the auditing of Libyan oil companies was held by the interviewees, and this situation was attributed to these firms' international reputation and their ability (through resources) to provide the service required by the oil companies. The nature of the market was considered, the point being made that more than 65% of it was under the Big Four firms' control creating a tight oligopoly-type of audit market, the remaining 35% being serviced by medium size audit firms. Strong competition was said to exist among the small and medium audit firms in respect of securing contracts.

It was perceived by the interviewees that the Big Four auditors were completely professional, doing a good job, and observing rules and regulations. It was the desire to protect the firm's reputation, the risk of professional sanctions and litigation from the regulators that the interviewees believed were

prime motivators of the Big Four firms' approach, and these subsequently resulted in safeguards to audit quality and independence, as observed in prior studies (Canning and Gwilliam, 1999; Farmer et al, 1987; Trompeter, 1994; Sori, 2005). Moreover, an audit supervisor in a Big Four audit firm stated:

Let me say, the competition started to get very stiff when international foreign audit firms and Arab firms came into Libya. These firms brought international standards, technological knowledge and they initially invested in both human resources and software, which, in turn, helped to build and develop a good auditing infrastructure and high reputation.

In contrast, a small minority (24%) of oil companies and audit firms indicated that a highly competitive market would affect auditor independence, and consequently, quality. Small firms mentioned this as a factor, being aware that their reliance on a relatively smaller number of clients for audit fees in such a competitive environment is perceived as a threat to audit quality and auditor independence both by large audit firms and the LAAA, causing the latter to propose the merging of smaller audit firms to reduce the unhealthy competition. One auditor from a local audit firm remarked:

To be honest with you, my independence is constantly under pressure not only due to the high competition of the audit market but also demanding clients. This makes me very uncomfortable. For instance, if I choose to qualify my audit report, the client could easily switch and find another firm willing to give him a clean opinion, it means poor quality. In such situations, it will decrease audit quality ... the practice of cutting down fees (low-balling) to attract audit clients should be banned. This may be done via some sanction to be put in place to forbid other firms from such conduct.

This finding is very consistent with that of Gray and Manson (2005) who found that there are possible negative effects on perceived audit quality arising from competition within the auditing profession.

However, summarising the findings as a whole on this variable, it can be seen that a highly competitive environment is perceived as improving audit quality. This outcome is consistent with economic theory that predicts a positive relationship between competition and quality. Copley and Doucet (1993b) found that entities receiving a greater number of bids for their audit engagements were significantly more likely to receive an audit of acceptable quality.

6.4.3.5 Fees for Audit Services and Audit Quality

The questionnaire survey findings presented in Chapter Five, section 5.4.5, revealed that as many as 70.8% of oil company respondents and 75.1% of audit firm respondents either agreed or strongly agreed with the statement: *Audit fee is positively associated with audit quality*. Moreover, just less than three-quarters of the oil company respondents (67.7%) and audit firm respondents (71.3%) either agreed or strongly agreed with the statement: *The Big Four firm usually charge higher audit fees and local firms usually charge lower audit fees*. These two results were confirmed by 80% of the interviewees.

Speaking about audit fees, an internal auditor of one of the oil companies said:

In my view, the audit fee is closely associated with the quality of audit services, any more fees increased hours of work that gives better services.

And an audit supervisor in a local audit firm added:

The low audit fees could directly impact on audit hours, by reducing the number of audit hours and the number of samples taken from the client's system.

This finding supports the results of the questionnaire survey presented in Chapter Five, section (5.4.5), which show that 70.8% of oil company respondents and 68.2% of audit firm respondents agreed with the statement: *An audit firm that charges high audit fees usually spends more audit hours with its clients and is most likely to provide high audit quality.*

This is another finding that is strongly in tune with the literature which reports (Deis and Giroux, 1992) that in a study relating to the effect of auditor changes on audit fees, audit hours and audit quality, the number of audit hours seemed to be an acceptable surrogate for audit quality differences among audit firms of similar size. Deis and Giroux (1992) argued that audit hours could also be linked to audit fees saying that if the audit effort declines with audit fees on initial audits, audit quality should also decline.

Just under three-quarters of the interviewees (72%) expressed the belief that the Big Four audit firms charge higher audit fees, and that these higher audit fees were associated with higher audit quality.

In this respect, an audit supervisor of one of the Big Four audit firms said:

When a financial statement is prepared and audited according to professional standards in a Big Four audit firm, it gains the appreciation of the readership. Hence, Big Four audit firms rely on this appreciation and ask for high audit fees for the privilege of using their name, reputation and logo on the client's financial statements ... you have to know, that the Big Four audit firms initially invested quite heavily in both infrastructure and high reputation. The Big Four audit firms usually get support from their head offices with any difficulties they face through a direct Internet connection.

Another financial manager in an oil company commented:

In fact, the Big Four audit firms take large fees for their services and most of the oil companies in Libya want to deal with these firms because they give good services and the high quality is better than the local audit firms.

A negative outcome on local audit firms was highlighted by an audit supervisor from one such firm, who remarked:

To be honest with you, a lot of local audit firms have left the market because they could no longer reduce their fees, as this would affect the quality of their work. Providing a comprehensive audit with a reasonable level of quality entails considerable expense, which has to be covered by the audit fees, but local audit firms cannot increase their fees because their clients will not accept this from them, whereas local audit firms affiliated to foreign audit firms can.

However, almost a third (28%) of those interviewed were of the opinion that higher fees were not necessarily an indication of audit quality, and one such interviewee, an auditor in a local audit firm said:

I think that higher audit fees are not related to audit quality ... I agree that Big Four audit firms charge high audit fees but I disagree that local audit firm charge lower audit fees.

Finally, in terms of differentiation in audit fees between local audit firms and foreign audit firms, Karim and Moizer (1996) examined the level of audit fees among auditors affiliated to foreign audit firms and those affiliated to purely domestic audit firms, finding that auditors affiliated to foreign audit firms secured higher audit fees than purely local audit firms. Audit firms provide differing quality audits, increasing with the size of firms, in response to varying demands for quality amongst clients because different companies have different levels of agency costs (Arrunada, 1999).

6.4.4 The Future Development of Audit Quality in Libya

The results of Section 5.5 of the questionnaire survey, presented in Chapter Five, revealed that a large majority (64.5% and 69.3%) of oil company respondents and (62.5% and 76.8%) of audit firm respondents either agreed or strongly agreed with the statements: *There should be legal and disciplinary actions available to the authorities against non-compliant and dishonest auditors* and *The current auditing rules and regulations in Libya need to be much improved*. Likewise, the interview data confirmed that the absence of severe penalties and the failure to publish details of audit firms that acted unprofessionally, had caused the overall audit quality in the country to drop. The majority of interviewees (92%) felt this way and stressed the need for improvements to the current auditing rules and regulations in Libya. Indeed, twenty three interviewees cited the absence of severe penalties as sanctions in the current rules and regulations, as the prime cause of poor quality.

In this respect, an auditor of a local audit firm said:

The absence of severe penalties and not publishing the name of audit firms performing unprofessional work caused a low level of audit quality ... The LAAA needs to shut down any audit firm found to be carrying out unprofessional work, as happens in developed countries.

And an audit supervisor of one of the Big Four audit firms remarked:

There is a need for legal and disciplinary actions to be available to the authorities against non-compliant and dishonest auditors and also the need for current auditing rules and regulations to be much improved.

Without exception, all the interviewees (100%) believed that the LAAA should adopt professional auditing and accounting standards to improve the audit quality. This finding was entirely in support of the questionnaire survey results presented in Chapter Five, section 5.5, that showed a large majority of oil company respondents (70.9%) and audit firm respondents (67.6%) either agreed or strongly agreed with the statement: *The LAAA should adopt international auditing and accounting standards to improve the audit quality and should have strict requirements for granting audit licenses.*

In this respect, one of the regulators commented:

After opening to the world, and the entry of international companies and oil companies, Libya must adopt international accounting standards leading to a distinct improvement in the level of quality for accounting in Libya.

Furthermore, over three-quarters of the interviewees (88%) insisted that an auditor should have experience before being granted a licence to open an audit office, as in their view experience in a profession is more important than qualifications. However, a regulator pointed out that:

The LAAA already require experience and qualifications. In terms of experience, they must have at least five years experience of accounting work in an accounting office after graduation before a licence is obtained and no audit firm can audit any company unless it has at least five years auditing experience.

On the same theme, another regulator added:

Only those holding an accounting qualification can apply for the licence. Those without it must take recommended courses to acquire the approved knowledge and skills and should have five or more years' experience in a full time accounting job and pass a special examination designed by the LAAA.

An internal auditor of one of the oil companies remarked:

The LAAA should force audit firms to attend continuing education courses for professional accountants and auditors, and an audit firm should not be able to renew its licence unless it has acquired a certain number of points from its employees' attendance on such courses. Courses focus on the latest developments in accounting and auditing practice around the world as well as practical solutions to accounting and auditing problems.

This issue of licensing was commented upon by an accounts manager in one of the oil companies, who said:

In my view the LAAA should impose strict conditions on each applicant for a licence to practise the profession.

Summarising the opinions of the research population in relation to the future development of the audit profession in Libya, it is clear that overwhelmingly, they all believe that the LAAA does not have sufficient power to impose a strict regulatory framework, and that the current requirements of auditors in Libya, are not enough to keep them up to date and fully aware of all developments in their line of work. It is felt that particularly with trade and economic liberalisation in Libya, the need to raise the level of professionalism is paramount and that enforceable legislation with appropriate penalties for misconduct, is very much, and urgently needed.

6.5 Summary

This chapter has presented the data from the interview exercise, conducted with staff from Libyan oil companies, and from audit firms in the Libyan market. The descriptive statistics showed that in total 25 interviews were undertaken, and that no participant had less than five years' experience in the auditing profession. This was encouraging since it indicated that the opinions that were being given, were considered and likely to be reflections of interviewees' true

beliefs formed over some years. Having found particular issues of interest emerging from the questionnaire survey, the researcher probed seven different areas concerning the prevailing level of audit quality in Libya, these being: firm size, the provision of NAS, auditor tenure, the level of competition in the audit market, and fees for audit services. After considering these particular issues, which were believed to be the most important when evaluating the audit quality function, the researcher also asked interviewees for their opinions regarding desired improvements to the Libyan auditing environment.

The interviews were informative, and helpful in confirming the data gathered during the questionnaire survey. Unfortunately, the vast majority of interviewees (96%) believed the current level of audit quality to be inadequate. They attributed this to a perceived lack of professionalism among auditors in Libya, which was considered to be a direct outcome of the LAAA's failure as a regulatory authority for the profession. In this respect, it was noted that the LAAA had not undertaken any classification exercise to indicate the size and resources of individual audit firms, nor had it provided any accounting or auditing principles or standards, or a Code of Ethics, as is observable in most other professions.

In their consideration of the main audit quality variables, interviewees generally believed that higher audit quality is associated with local audit firms affiliated to foreign audit firms, and especially those affiliated to one of the Big Four, rather than with ordinary local audit firms. The reason for this was basically the fact that international firms have greater resources and experience, and can as a result, sponsor their staff for ongoing professional

development. Small and medium firms are unable to compete on these dimensions. Moreover, it was pointed out that because of their better treatment, the staff in the Big Four firms are more loyal to their companies, and more able to resist client pressure than their counterparts from local audit firms.

In terms of the provision of NAS and the potential for this to jeopardise independence, the general consensus among interviewees was that this was an unfounded concern, and that provided separate department in the audit company were involved, there were only benefits to be realised. Indeed, interviewees confirmed that they would recommend their audit clients come to them for NAS because the auditor's experience and understanding of their businesses results in better consultancy advice being given. Long tenure, was generally, believed to be risky and mandatory rotation, although over a five-year rather than a three-year period, was favoured, especially in oil companies. Oil companies were very much aware of their importance to the country's economy, and the need to retain reputation in the investment market, which it was felt mandatory rotation of auditors would give them.

On the issue of competition in the audit market, it was revealed that in Libya there is a highly competitive audit environment and that the need to perform a quality audit service was important in order to keep abreast of the competition, although there were simultaneous fears that in an environment where there are more suppliers than demand, price under-cutting might be detrimental to quality. This issue of price was taken up again in discussions of the relationship between audit fees and audit quality, with it being reported quite definitely that a positive association was seen between the two. The Big Four audit firms were

perceived as charging a premium (therefore being expensive) but providing a quality job, the local firms were perceived as being less expensive but not providing the same quality audit staff, and the local audit firms affiliated to foreign audit firms were perceived by the vast majority of respondents to be in the middle - providing high audit quality and at a reasonable audit fee.

The last area for discussion, how to improve audit quality, centred entirely on the role and power of the LAAA, which it was felt should adopt professional auditing and accounting standards, and implement a more rigorous regulatory framework with a system of monitoring and penalties as a means of enhancing professional performance. Chapter Seven draws the thesis to a conclusion and offers a number of recommendations to raise the level of professionalism within the Libyan audit environment.

CHAPTER SEVEN

CONCLUSION AND RECOMMENDATIONS

7.1 Introduction

This chapter provides an overview of the entire thesis and draws it to a conclusion. It summarises the main findings and sets out the individual conclusions which can be drawn in each of the main areas that have been investigated. It also provides recommendations that might be of interest and assistance not only to the environment studied, that being the Libyan auditing profession, but also to the auditing environment in other countries, in bringing about improvements to audit quality, and thus increasing the quality of the audit work with the ultimate aim of restoring and enhancing public trust in the audit profession. Furthermore, the chapter considers the limitations of the thesis and opportunities for further research.

There are six sections, including this introduction, within the chapter. Section 7.2 provides a summary and review of the findings and discussions presented in the previous chapters. Recommendations of the study are presented in section 7.3. Section 7.4 discusses the limitations of the work, showing how these were dealt with during the actual research process. Section 7.5 proceeds to suggest avenues for future research, and Section 7.6 draws the thesis to a final conclusion.

7.2 Summary and Review of Findings

This thesis has examined the current perceptions of the level of audit quality in Libya. The scope of the study was restricted to involve an exploration of five major variables, these being: the size of the audit firm, the provision of non-audit services (NAS), auditor tenure, level of competition in the audit market, and the fees charged for audit services. As a means of exploring the central issue from both dimensions, the study was conducted on the demand side (Libyan oil companies) and on the supply side (audit firms working in Libya).

It seemed logical to start the research work by addressing specific issues including the identification of the area of study, research objectives and questions, the epistemological and methodological framework, contribution to knowledge, and structure of the thesis. There were several reasons for conducting this study, the most pressing being that most previous studies have focused on auditor independence only, and on examining the relationship between one or two variables of audit quality in the developed countries. No emphasis has been given to audit quality, and it was in response to this apparent gap in the literature that this study was originally undertaken. In addition to this shortfall in the literature, two other important points were highlighted. The first concerns the fact that most of the literature in this research field has been written with reference to developed countries and that research in developing countries, of which Libya is one, has received scant attention. Secondly, no similar study to the one reported in this thesis has been conducted either in Libya or North Africa as a wider region.

Notably, the Libyan audit profession offers a valuable research context in that it is a developing market and one that is not totally dominated by the large multinational audit firms. Consequently, the Libyan context allows for a comparison of such firms against smaller, national audit firms.

Additionally, it is argued that the findings of this thesis are pertinent given the current level of debate internationally over the role, regulation and quality of auditing services and concerns over the potential impact of recent corporate scandals on auditor reputation.

By reviewing previous literature relevant to this study, the researcher was able to identify where contributions to the existing literature are needed. The literature review was used to generate a frame of reference for developing the issues raised and discussed in the thesis, and helped in formulating the experimental instrument as well as the questions addressed in the semi-structured interviews. The results of the present study will undoubtedly, help auditors, audit clients and regulators to take pre-emptive measures to improve monitoring activities and instil investor confidence in the Libyan audit market.

7.2.1 The Current Perceptions of Audit Quality in Libya

The results of the questionnaire survey and the interviews revealed that the vast majority of respondents disagreed with the idea that the Libyan Accountants and Auditors Association (LAAA) plays an important role in developing the auditing profession, and thereby enhancing quality. Respondents were, in fact, dissatisfied with the current level of audit quality in Libya, and indicated a preference for Big Four audit firms other than local audit firms because they

are perceived to offer a better quality product. Indeed, because most oil companies prefer to engage audit firms that are affiliated to a foreign audit firm, as confirmed by the majority of participants, these firms tend to dominate the Libyan audit market. Again, the majority of the respondents involved in this study were of the opinion that most audit firms in Libya are unfamiliar with new audit services, such as assurance services and internet reporting. This situation may arise either because the majority of audit clients in Libya are still audited using traditional ways of auditing services, or because oil companies that provided the sample for the study, do not themselves have any idea about such new services. This particular finding is consistent with the literature (see Mautz and Sharaf, 1961).

In respect of the interviewees, they felt it was as a huge shortcoming of the LAAA that it had not undertaken any classification of audit firms in Libya on the basis of number of employees, revenue, and resources, and that it had not provided the profession with any principles or standards of accounting or auditing, nor formulated a Code of Ethics as is present in most other professions as a soft regulatory mechanism.

In fact, it can be seen that the LAAA has actually failed to regulate itself since had this been done, it would have recognised its obligation towards the public interest. Furthermore, it has not achieved its objectives associated with the promotion of activities such as research, conferences, academic publications, and seminars. This failure, together with the lack of any programme of continuing education and training has resulted in the absence of any effort to improve the status of the profession and accordingly, the individual status of its

members. Moreover, the LAAA specifies no uniform audit report requirements, or professional examination requirements. Clearly, it can be concluded that the Libyan accounting profession is extremely weak when evaluated against that in other countries, especially in the advanced nations.

Hence, the interviewees' opinions were not favourable about the current level of audit quality. The lack of the professionalism among auditors in Libya, the weaknesses in the current regulatory framework, the ineffectiveness of the LAAA, the ignorance of audit firms in Libya in respect of new services, and the inability of Libya's education system to produce graduates of a good enough calibre, all combine to cause the low level of audit quality that the profession itself wishes to improve.

7.2.2 Factors Impairing and Enhancing Audit Quality

In relation to the impact of different sizes of audit firms on audit quality, a clear majority of oil companies and audit firms agreed that Big Four firms are superior to their non-Big Four counterparts in all of the reputation issues presented to them, and that the size of the audit firm is positively associated with audit quality.

Firstly, the questionnaire respondents concluded that Big Four audit firms are more attractive to investors and creditors because they are seen to provide reliable information that enables investors to properly assess risk and return profiles. Investors usually trust audit firms with a professional approach to auditing and a high level of audit quality. In the same manner, oil companies usually engage audit firms with a good reputation because they wish to

enhance their own attractiveness to investors and creditors, and Big Four audit firms are considered to be better able to resist management pressure in conflict situations, thereby bringing enhanced credibility to any company that uses their auditing services. A further point in their favour is that as noted in the literature review in Chapter Three, the Big Four auditors have greater resources, technical knowledge and global reach, which allows them to deal with clients more efficiently, and they are thus able to freely express their opinions without fear of their engagement being terminated by the client. In fact, Big Four audit firms may also exhibit higher levels of ethical reasoning and attract a greater variety of clients because of their appeal on quality grounds, and the associated benefits their reputation brings. Indeed, as the Big Four audit firms have greater resources and possess technological capabilities, they can plan the audit process more effectively, perform more powerful tests, and be more likely to publish more precise information.

Secondly, the majority of oil companies and audit firms agreed that Big Four audit firms are more risk averse and consequently, more disinclined to be associated with public scandals and/or audit failures than non-Big Four audit firms. These opinions might be an indication of the faith that the respondents still have in the ability and competence of the Big Four to undertake their duties effectively and professionally, despite the well-publicised audit failures involving large firms that have occurred in different economic, political, geographical and cultural settings, which may not be applicable to the Libyan audit market. It is possible that the invention of communication technology that allows business to be done in real-time has made the Big Four auditors more

careful in conducting their business and more risk averse, with the result that their reluctance to be associated with any wrongdoings is enhanced, since the availability of such technology would result in faster spread of negative news.

Finally, the majority of the respondents to the questionnaire recorded their belief that Big Four audit firms are more independent than non-Big Four auditors. Indeed, the Big Four auditors are likely to become the subject of interest to the public and regulators, especially when they are suspected of exhibiting negative behaviour. Therefore, Big Four audit firms have more incentive to behave independently than non-Big Four audit firms.

The results of the interview survey revealed that the perceived relationship between firm size and level of audit quality is consistent with the notion that higher audit quality is associated with foreign audit firms, in general.

In this connection, the interviewees were of the opinion that the Big Four firms were more independent than their counterpart non-Big Four firms, and this was seen as a direct result of their size, since this provided them with more resources that in turn filtered through to organisational practices, such as the provision of more training that ensures staff are skilled and effective in diagnosing activities that are inconsistent with a client's going-concern status. Such elements of organisational culture allow for the recruitment of more professionally-minded people, who subsequently provide a higher quality of service. It was felt by the interviewees that such high quality staff would naturally comply with international professional standards and work ethically, thereby being predisposed to resist management pressure. Overall, the Big Four firms were reported to be more powerful, effective and independent than the

non-Big four firms, not least because after various accounting scandals and litigation concerning fraud and irregularities, they have more incentive to protect their reputation and continue with their high earnings.

The provision of non-audit services (NAS) that has been debated in the literature as a cause of impaired audit quality, was considered by the majority of this study's respondents not to be a serious concern, and the statement that the provision of NAS would impair the level of audit quality did not secure very much agreement. In fact, the majority of respondents believed that the provision of NAS to audit clients gives the auditor more experience of the client's industry as well as more access to the client's accounting system, thereby functioning in a complementary capacity. Hence, such an arrangement was considered to increase the auditor's overall client knowledge, and therefore enhance the probability that problems would be discovered. In such circumstances, the provision of NAS was argued to have the potential for actually increasing audit quality. Furthermore, from the auditor's perspective, the provision of NAS was considered favourable, since the arrangement has the potential to increase a client's dependence on its auditor, thereby reducing the credibility of the switch threat, although such dependence, when viewed from a different perspective, could be perceived as a negative feature. Another commonly-mentioned advantage of the joint provision of audit and NAS, is the benefit arising from knowledge spillovers, which are transfers of knowledge that may occur when NAS are provided by the incumbent auditor

It was, however, agreed by the majority of the respondents that the maintenance of audit quality would require the provision of NAS to come from

a separate department from the audit department. This degree of faith was interesting, and testified to the respondents' belief in the 'Chinese Wall' approach, which works to minimise communication between the audit and NAS providers despite them being under the ultimate control of the same organisation. Given that the government licenses individual auditors, and these people have to ensure that their personal image is protected, it is argued that auditors would not behave in a way as to compromise this, and in fact, welcome greater monitoring of their own activities.

The general feeling among interviewees was that they would recommend their own firms to their clients for the provision of NAS, since they believed this would not result in any reduction in the audit quality, and indeed, enhance it.

In relation to the impact of long tenure on audit quality, discussed in Chapter Three, the majority of respondents in this study were of the opinion that long tenure provided an auditor with more knowledge and experience about a client's specific operations and business processes, but that it brought with it the potential for relationships that might eventually impair auditor independence, and hence, the level of audit quality. One way in which this might occur is as a result of the auditor believing him/herself to be so familiar with the client that audit hours could be reduced, thereby risking effectiveness and engendering complacency.

As a means to combat the potential for the development of cosy relationships, the majority of respondents believed that mandatory rotation would provide a solution since this would prevent auditors from becoming economically dependent on particular clients. It would also place auditors in a better position

to disagree with management on professional matters, and the specification of a certain period of time would be such as to prevent the development of bias. Consequently, it was felt overall, that mandatory rotation of audit firms would enhance audit quality since it would prevent a lessening of objectivity.

Interviewees also were generally in favour of mandatory rotation of audit firms, believing that this practice would enhance audit quality since lengthy tenure may well lead to a negative impact on quality, arising from overly strong relationships with the board of directors and general manager.

At the same time, however, caution was expressed in terms of excessive switching costs and higher audit risk that might arise with too short a period of tenure. Certainly, in the first and second year of auditing, it was reported that auditors put in many hours in order to become familiar with the client's business and that once such a level of expertise has been gained, it should be capitalised upon, otherwise there will be a continual round of high set-up costs to be faced by clients, and the possibility that the auditor's expertise will not be fully developed when s/he comes to the end of the engagement. Consequently, the research population in this study favoured a five-year audit contract period rather than a three-year period.

In respect of the degree of competition in the audit market, the impression gained from the questionnaire survey was that audit quality would not be negatively influenced by a highly-competitive environment. In addition, the majority of respondents disagreed with the statement that audit quality may be impaired if there is audit fee discounting or low-balling at initial engagement. These findings seem to suggest that the respondents were confident that the

players in the large companies' audit market are able to maintain their independence, and to provide good audit quality, possibly because of their concern with maintaining their good reputation, a factor that acts as a deterrent to inappropriate behaviour. Also, the Libyan audit market is concentrated in audit firms that are affiliated to foreign audit firms, and this has the potential for enhancing the regulators' role in terms of monitoring the behaviour of a small number of key players.

The Libyan market was generally accepted by respondents as being highly competitive and to follow the theoretical predictions that a positive relationship exists between competition and quality, especially as it was reported that some audit firms had left the market because they were unable to rise to the challenge to provide better services. They did not consider that audit quality may be negatively influenced if audit fee discounting occurred at initial engagement. It was believed that there was no unfavourable impact on quality as a result of the small but highly-competitive environment because the Big Four audit companies, and firms that were affiliated to them, were players within it and their reputations were such as to inspire confidence.

Indeed, as the interviewees noted, the facets providing the Big Four firms with competitive edge were indicated as amount of resources, technical knowledge and experience, and global reach, all unavailable to the majority of the small local audit firms which are left to service the residual market. The interviewees commented that around 500 audit firms operate in the Libyan audit market but that the Big Four and medium size audit firms pose barriers to entry to the

smaller local firms, which do compete with each other, but not in a way as to affect the profession as a whole.

Regarding the relationship between the fees for audit services and audit quality, the majority of respondents believed the relationship between the audit fees and the level of audit quality is positive, and that clear differences could be seen between local firms, local firms affiliated firms to one of the Big Four audit firms, and the Big Four audit firms themselves. In this respect, the local audit firms expressed their dissatisfaction with the level of audit fees they received, and consequently, they suggested the establishment of an independent body to specify the amount of audit fees paid to all audit firms. However, it was acknowledged that the Big Four audit firms customarily receive higher audit fees than others, recognising that such a premium was a reflection of more audit hours, the ability to use more and better resources, and a better quality service, especially in respect of initial audits.

The majority of interviewees disclosed that the audit fee is linked closely associated with the audit quality. Also the majority of interviewees did hold the opinion that local audit firms affiliated to foreign and one of the Big Four audit firms were providing a high audit quality and that they were seen to make initial heavy investments in their infrastructure. Such investments were seen in the use of particular diagnostic software, and in efforts to develop human resources, which in turn helped in the promotion of a good reputation. In addition, firms associated with the Big Four audit firms are usually supported in technical areas (direct Internet connection) and in the provision of academic publications in the area of accounting/auditing, and specialist team visits.

7.2.3 Potential Improvements to the Libyan Auditing Environment

The majority of the respondents believed strongly in the need for legal and disciplinary sanctions as a means of regulating the audit environment and ridding it of non-compliant and dishonest auditors. They also strongly advocated for an improvement to the current auditing rules and regulations to bring them into line with international auditing and accounting standards, and therefore put into place a framework for improving audit quality. Additionally, it was believed that there should be stricter criteria imposed when granting audit licences.

In respect of the provision of NAS, it was felt by the majority of respondents that whilst this was essentially considered by them to be a good thing, audit firms should, nonetheless, disclose the type and amount of NAS provided to their audit clients, and likewise, oil companies should disclose in their annual reports, the amount of audit and NAS fees paid.

A large majority of oil company respondents, compared to audit firm respondents, believed that the percentage of NAS income for audit firms should not be higher than 25% of total audit firm revenue generated from a single client. Unsurprisingly, the perceptions of the respondents seem to be consistent and this might reflect their concern about the threat faced by auditors when depending heavily on a single client, since such an arrangement may compromise their ability to behave independently (see for example, Flint, 1988).

The majority of interviewees suggested ways in which the LAAA should enhance its role and influence on audit firms in order to encourage and monitor their professional performance, such as adopting severe penalties for audit firms behaving unprofessionally, and publishing their names. It was felt by most interviewees that the criteria for obtaining a licence to open an audit office should be tightened to require experience, as they considered experience in the profession to be more important than qualifications. The suggestion was that people could become registered as Chartered Accountants once they had accumulated five or more years' experience in a full-time accounting job, and passed a special examination designed by the LAAA. Finally, it was overwhelmingly believed that it was necessary for the LAAA to adopt international auditing and accounting standards as a means to improving audit quality.

7.3 Recommendations of the Study

The findings reported in this study highlight as a general and urgent concern, the fact that audit quality in Libya needs to be improved, and that it is perhaps the developing country context that is a major problem in relation to the smaller, local audit firms. Clearly, the peculiar and very special nature of the Libyan environment, as one in which a highly-prized resource (oil) forms the backbone of the economy and makes a substantial international economic contribution also, means that the audit environment is characterised by the full range of audit providers, covering local audit firms, local audit firms with some affiliation to foreign audit firms, and the Big Four audit firms themselves. This is a reflection of the need for confidence amongst investors in the Libyan oil

industry. Given the heterogeneity of the market, it is not surprising that audit quality is seen to operate on a spectrum, with the Big Four at one end, and the small local firms at the other. As recommendations to create more uniformity in the market, moving in the direction of improved quality, the study derives the following from the findings:

1. The LAAA should be given new powers to strengthen its role as the national regulator for the accounting and auditing profession in Libya. It should be empowered to ensure that standards and sanctions related to audit quality are formulated, in place, and enforced. This will require considerable reform in respect of the LAAA's role and responsibilities.
2. The LAAA should adopt international auditing and accounting standards and impose strict criteria in respect of the issue and renewal of audit licences.
3. The audit practice of current auditors should be strengthened by the provision of ongoing training by all audit firms, which should be a requirement imposed and monitored by the LAAA, and form part of the conditions for licence renewal. As part of this ongoing training, it is recommended that auditors be given experience across different industries to broaden their skills and expertise. Moreover, the LAAA should be responsible for providing its members with scholarly material in respect of international auditing practice, as well as practical solutions to accounting and auditing problems.

4. The current accounting and auditing curriculum in the Libyan education system should be revised and updated to ensure the appropriate training for auditors, and sufficient scholarly research should be undertaken in the HE environment to ensure that the auditing model in use in Libya is appropriate when compared with international models, and the needs of the Libyan system.
5. Among the standards to be set by the LAAA, should be the requirement for the separation of duties in respect of the provision of audit services and NAS, and for audit firms' percentage of NAS income from a single client not to exceed 25% of the fees obtained from that client. Additionally, the LAAA should require audit firms to disclose the type and amount of audit and NAS fees obtained from all clients.
6. Legislation should be passed to require all companies (specifically oil companies) to report the respective fees paid to their auditors for audit services, and NAS.
7. Local audit firms should be encouraged by the LAAA to merge to *create a strong group of enterprises capable of competing effectively with those that are affiliated to foreign audit firms. They should create their own international reach through affiliation with renowned international firms or open up international offices to cater for their clients' needs. Global reach is important for multinational companies that operate in various countries, which need such a service to tackle international business and reporting issues.*

4. The current accounting and auditing curriculum in the Libyan education system should be revised and updated to ensure the appropriate training for auditors, and sufficient scholarly research should be undertaken in the HE environment to ensure that the auditing model in use in Libya is appropriate when compared with international models, and the needs of the Libyan system.
5. Among the standards to be set by the LAAA, should be the requirement for the separation of duties in respect of the provision of audit services and NAS, and for audit firms' percentage of NAS income from a single client not to exceed 25% of the fees obtained from that client. Additionally, the LAAA should require audit firms to disclose the type and amount of audit and NAS fees obtained from all clients.
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8. The mandatory rotation of auditors on a five-year basis should be a feature of the Libyan environment, overseen by the LAAA. The period of five years will allow auditors to gain an appropriate length of experience with particular clients, and hence the type of business in which they are engaged.
9. Attention should be paid to the development of the audit profession in Libya to ensure there is no monopolisation by the Big Four audit firms, and to ensure the development of national cadres and local audit firms as a means of expanding competition within the audit market.
10. Further research, as documented in section 7.5 should be undertaken.

7.4 Limitations of the Research

As with all research, this particular study has some limitations, most of which are connected to the nature of the exercise (PhD study with limited resources). The various shortcomings of the data collection methods (questionnaire and semi-structured interviews) adopted for the study have been discussed in detail in Chapters Five and Six. Consequently, this section will ignore these.

Firstly, the findings and conclusions should be treated with some caution since the study was concerned with the perceptions of only two groups of subjects, namely audit firm and oil company staff. Hence, it is not possible to make widespread generalisations (for instance among shareholders, industrial sectors, listed companies, public companies, bank sectors).

Secondly, as the research population was exclusively comprised of people with experience based on Libyan rules, practices and procedures, the results and explanations are not necessarily applicable to other jurisdictions. There may be room for generalisation to other North African countries, and possibly to the wider Arab World, but cultural differences may prevent wider applicability.

Thirdly, a review of the literature indicated that no studies had been conducted on the topic under investigation in Libya, and consequently, the research framework was developed according to constructs that have been developed in other environments, particularly, Anglo-Saxon countries. The focus was on five factors identified as potentially impairing audit quality, and it may be that other factors are influential in the Libyan environment.

Finally, it must be acknowledged that there are limitations when drawing conclusions from a perceptual-based survey, since the respondents' subjectivities may affect their ability to respond objectively. This may arise, for instance, in the situation where a respondent wishes to support his/her organisation and answers in a particular way to do so, when in fact, the truth of the matter is different.

7.5 Suggestions for Future Research

As indicated in the previous section, the results reported in this study suggest room and directions for more research. In this respect, three major opportunities present themselves. Firstly, the study could be replicated to include the opinions of people in different industrial sectors in an attempt to gain a wider picture of the perception of audit quality in Libya, and the factors

influencing it. Secondly, the study could be replicated in other oil-producing countries to determine whether the oil industry brings to the audit environment any peculiarities. Thirdly, the study could be replicated with other industrial sectors across other North African countries and/or countries in the Arab World generally, to establish whether cultural influences are at work in perceptions of audit quality. Such a study might highlight the existence of new and additional factors that might come into play, that are not reported in the western literature.

7.6 Overall Conclusion

The study has been exploratory in nature, and has considered the Libyan audit environment using the oil sector as the unit of analysis. Given the international nature of Libya's oil industry, it is believed that the findings of the study provide important directions for the Libyan government in regulating the audit profession and thereby promoting Libya to foreign investors, not just in the oil sector but in other areas of the economy. It is believed, therefore, that the study has made several contributions in terms of both the literature, and the future development of a nation.

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Appendix 1: The Questionnaire Survey

Liverpool John Moores University

**An Investigation into the Perception of Oil Companies and
Audit Firms on Factors Affecting Service Quality of Auditing**

Questionnaire



Dear respondents

I am currently engaged in research for PhD at Liverpool John Moores University, UK. I am particularly interested in Audit Quality in Libya. So, the purpose of this survey is to collect some of the research data.

I would like to invite you to participate in this research by completing this questionnaire (from your own experiences) which should take no longer than 15 minutes to complete. I have left space to write if there are any notes you think that might contribute in improving this research.

I would like to assure you that all responses to the questionnaire will be kept confidential.

Thank you very much for your cooperation.

Yours faithfully
Nedal Sawan
Ph.D. student
Business school
Liverpool John Moores University
Email: N.SAWAN@2007.ljmu.ac.uk
Ne2000dal@hotmail.com

SECTION B: CURRENT PERCEPTION OF AUDIT QUALITY IN LIBYA.

Please indicate the extent to which you agree or disagree with the following statements by ticking.

Strongly Disagree	Disagree	No View	Agree	Strongly Agree
1	2	3	4	5

No		1	2	3	4	5
1	Rules and regulations in Libyan are not comprehensive provisions that lack and cause low audit quality					
2	The current level of audit quality in Libya is insufficient					
3	The Libyan Accountants and Auditors Association (LAAA) plays an important role in developing the profession of auditing and enhances audit quality.					
4	The accounting and auditing curricula in the Libyan education system are insufficient to train auditors.					
5	The lack of professionalism of auditors in Libya causes the low level of audit quality					
6	Most oil companies in Libya prefer audit firms that are affiliated to foreign audit firm and audit quality depends on the status of the audit firm e.g. local affiliated to a foreign audit firm					
7	Most audit firms in Libya have little idea about new audit services, such as assurance services and internet reporting.					

SECTION C: FACTORS IMPAIRING AND ENHANCING AUDIT QUALITY

C1) Audit Firm Size: please indicate the extent to which you agree or disagree with the following statements by ticking.

Strongly Disagree	Disagree	No View	Agree	Strongly Agree
1	2	3	4	5

No		1	2	3	4	5
1	The size of the audit firm is positively associated with audit quality.					
2	The Big Four firms can report the real financial situation of the clients more readily than other firms.					
3	The Big Four firms are more risk averse in respect of damage to their reputation from public scandals and/or audit failures.					
4	The Big Four firms perform more powerful, effective tests and are more credible than others					
5	The Big Four Firms achieve a high level of audit quality					
6	The local audit firms achieve a lower level of audit quality					
7	The companies audited by the Big firms are more attractive to investors and creditors.					
8	The Big Four firms can plan the audit process more effectively and can obtain a greater variety of clients.					
9	The Big Four firms more independent and more likely to issue qualified reports					

C2) Non-Audit Services (NAS): please indicate the extent to which you agree or disagree with the following statements ticking.

Strongly Disagree	Disagree	No View	Agree	Strongly Agree
1	2	3	4	5

No		1	2	3	4	5
1	The provision of NAS to an audit client gives the auditor more experience of the clients industry and more access to the clients accounting system.					
2	The provision of NAS to an audit client leads to economic dependency on that client and causes a conflict of interests for the auditor.					
3	Only certain types of NAS impair audit quality.					
4	The prohibition of the provision of NAS to an audit client is only to maintain the perception of independence.					
5	Providing NAS to an audit client by a separate department gives the auditor more credibility.					
6	The provision of NAS impairs audit quality.					
7	The provision of NAS to an audit client reduces the probability of switch threat change of auditor.					

C3) Auditor Tenure: The relationship between an auditor and his clients is always under scrutiny. In this context, please indicate the extent to which you agree or disagree with the following statements by ticking.

Strongly Disagree	Disagree	No View	Agree	Strongly Agree
1	2	3	4	5

No		1	2	3	4	5
1	Policy of mandatory rotation leads to reduction in any relationship between the client and auditor					
2	The mandatory rotation is positively associated with audit quality.					
3	Long tenure can impair auditor independence.					
4	Long tenure with a client gives an auditor more experience and leads to low audit hours by an auditor					
5	Long tenure should only be allowed with large companies					
6	Mandatory rotation harms the technical competence of auditing and leads to lack of knowledge and familiarity with the clients accounting system.					
7	Mandatory rotation makes the audit market less competitive and causes higher audit fees.					
8	The auditor will not become economically dependent by specifying a period of tenure.					

C4) Audit Market Competitiveness:

Strongly Disagree	Disagree	No View	Agree	Strongly Agree
1	2	3	4	5

No		1	2	3	4	5
1	The audit market in Libya is highly competitive.					
2	Audit quality may be impacted if the audit firm operates in a highly competitive environment					
3	Audit quality may be impacted if there is audit fee discounting or low-balling at initial engagement.					

C 5) Audit Fees: It is suggested that "The more you pay the more professional work you receive". In this context, please indicate the extent to which you agree or disagree with the following statements by ticking.

Strongly Disagree	Disagree	No View	Agree	Strongly Agree
1	2	3	4	5

No		1	2	3	4	5
1	Audit fee is positively associated with audit quality.					
2	An audit firm that charges high audit fees usually spends more audit hours with its clients and is most likely to provide high audit quality.					
3	Audit fees that are specified by an independent professional body will lead to higher audit quality.					
4	Audit fees are increased to allow more thorough scrutiny of the clients accounting system.					
5	A company that pays higher audit fees is more likely to receive a clean audit opinion.					
6	A company that is receiving NAS from its external auditor is most likely to be charged lower audit fees					
7	The Big firm usually charge higher audit fees and local firms usually charge lower audit fees					
8	Audit fees remaining between a specified minimum and maximum amount will result in higher audit quality.					

SECTION D: FUTURE DEVELOPMENT OF AUDIT QUALITY IN LIBYA

Please indicate the extent to which you agree or disagree with the following statements by ticking.

Strongly Disagree	Disagree	No View	Agree	Strongly Agree
1	2	3	4	5

No		1	2	3	4	5
1	Audit firms in Libya should adhere to audit quality requirements.					
2	The LAAA should adopt international auditing and accounting standards to improve audit quality and should have strict requirements for granting audit licenses.					
3	There should be legal and disciplinary actions available to the authorities against non-compliant and dishonest auditors.					
4	Audit firms in Libya should be restricted to undertaking only audit work.					
5	The current auditing rules and regulations need to be much improved.					
6	A range of audit fees should be specified by the Libyan regulatory authority that allocates audit clients to audit firms					
7	Audit firms should disclose the type and amount of NAS provided to their audit clients and oil companies should disclose the amount of audit and NAS fees paid in the annual report.					
8	The percentage of NAS income for audit firms should not be higher than 25%of total audit firm revenue is generated from single client.					

If you have any comments or propositions you might think regarding the issues presented and covered by this questionnaire, please do not hesitate to write them down here.

.....

**Thank you for your cooperation**

Appendix 2: Interview Survey Questions in English

Section A. Demographic Information

Name of Interviewee

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.....
.....

Name of Audit Firm

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.....

Could you please tell me a little about yourself in terms of your experience?

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.....
.....

Section B: The Current Perception of Audit quality in Libya

- Do you think that audit quality in Libya is still insufficient; could you please explain why do you think this might be?

.....
.....
.....

- Do you think the LAAA is playing an effective role to enhance audit quality?

.....
.....
.....

Section C: Factors Impairing and Enhancing Audit Quality

Firm Size

- Do you think audit quality in Libya depends on the status of the audit firm e.g. local audit firm affiliated to a foreign audit firm? If so, what are the problems in terms of audit quality with local audit firms?

.....
.....
.....

- Is there any different in term of audit quality if a Big Four audit firm and a non-Big Four audit firm audits client?

1. Provide a higher level of audit quality
2. Damage of reputation.
3. Independence.
4. More powerful, effective and attractive to investors and creditors
5. Resist management pressure

In what perspective? How this situation happens

The Provision of Non-Audit Service (NAS)

- Do you believe non-audit services offered to audit clients affect the audit quality or perceived audit quality

.....
.....
.....

- Do you think that providing Non-Audit Service (NAS) by a separate department gives the audit more credibility?

.....
.....
.....

The length of auditor tenure:

- Do you think that the mandatory rotation has positively associated with audit quality?

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.....
.....

- Do you think that long-term audit tenure impairs audit independence? If so, why do you think this is?

.....
.....
.....

The Level of Competition in the Audit Market

- In your view, to what extent does stiff competition for audit client in audit market impact audit quality?

.....
.....
.....

Fees for Audit Services

- Do you think that the audit fee has positively associated with audit quality?

.....
.....
.....

- Do you think the Big Four audit firms charge higher audit fees than non-Big Four and these higher audit fees associated with higher audit quality?

.....
.....
.....

Section D: The Improvements of the Level of Audit Quality

- What would change things for the better, in terms of improving the audit and enhancing audit quality in Libya? And what might be the role of the LAAA in that sense?

Appendix 3: The Questionnaire Survey Questions in Arabic

استبيان لتقييم جودة خدمات المراجعة المالية من وجهة نظر معدي الخدمة و مستخدميها في شركات النفط الليبية ومكاتب المراجعة العاملة في البيئة الليبية

القسم الأول: - الرجاء وضع علامة (□) في المكان المخصص

- 1-الجنس: (أ) ذكر (ب) أنثى
- 2- الفئة العمرية: (أ) من 20 إلى 39 سنة (ب) من 30 إلى 39 سنة (ج) من 40 إلى 49 سنة (د) 50 أو أكثر
- 3- (أ) الرجاء تحديد المنصب الوظيفي الذي تشغله: (يتم ملئه من قبل موظفي مكتب المحاسبة)
 أ- شريك ادارى ب- مشرف مراجعة ج- مراجع
- 4- مدة الخبرة:
 أ- اقل من خمس سنوات ب- ما بين 5 سنوات و10 سنوات
 ج- اكثر من عشر سنوات
- 5- الرجاء تحديد اعلى مؤهل تعليمي اكاديمي حصلت عليه.
 أ- الثانويه العامة ب- البكالوريس ج- دبلوم عالي
 د- الماجستير هـ-الدكتوراه (او مايعادلها) و- اخرى
- 6-الرجاء تحديد المؤهل المهني الذي تحمله
 أ- لاشي
 ب - معهد المحاسبين القانونيين في انجلترا وويلز
 ج- شهادة عضوية مجمع المحاسبين القانونيين الاداريين
 د-شهادة عضوية جمعية المحاسبين القانونيين المعتمدين
 هـ - شهادة عضوية جمعية المحاسبين المعتمدين بالولايات المتحدة الامريكية
 و- شهادة عضوية المجمع العربي للمحاسبين القانونيين
 ز- عضوية نقابة المحاسبين والمراجعين القانونيين الليبيين
 ح- اخرى

7-الرجاء تحديد نزعية مكتب المراجعة الذي تتعامل معه شركتكم هذا العام

1	مكتب مراجعة محلي
3	مكتب مراجعة محلي مرتبط بمكتب مراجعة اجنبي
4	مكتب مراجعة محلي مرتبط باحد مكاتب الاربعة الكبار

8- هل مكتبكم يقدم خدمات استشارية لعملائها؟

(يتم ملئه من قبل موظفي مكتب المراجعة فقط)

1	نعم
2	لا

القسم الأول : - الرجاء وضع علامة (□) في المكان المخصص

(ب) أنثى
(ب) من 30 إلى 39 سنة
(د) 50 أو أكثر

1-الجنس:
2- الفئة العمرية:
(أ) ذكر
(أ) من 20 إلى 39 سنة
(ج) من 40 إلى 49 سنة

3- (أ) الرجاء تحديد المنصب الوظيفي الذي تشغله: (يتم ملئه من قبل موظفي الشركة)

(أ) المراجع الداخلي □ (ب) المدير المالي □ (ج) مدير حسابات □
ز- اخرى.....

4- مدة الخبرة:

أ- أقل من خمس سنوات □ (ب) ما بين 5 سنوات و10 سنوات □
ج- أكثر من عشر سنوات □

5- الرجاء تحديد اعلى مؤهل تعليمي اكاديمي حصلت عليه

أ- الثانويه العامة □ (ب) البكالوريس □ (ج) دبلوم عالي □
د- الماجستير □ (هـ) الدكتوراه (او مايعادلها) □ (و) اخرى □

6- الرجاء تحديد المؤهل المهني الذي تحمله

أ- لاشي

- () ب - معهد المحاسبين القانونيين في انجلترا وويلز
() ج- شهادة عضوية مجمع المحاسبين القانونيين الاداريين
() د- شهادة عضوية جمعية المحاسبين القانونيين المعتمدين
() هـ - شهادة عضوية جمعية المحاسبين المعتمدين بالولايات المتحدة الامريكية
() و- شهادة عضوية المجمع العربي للمحاسبين القانونيين
() ز- عضوية نقابة المحاسبين والمراجعين القانونيين الليبيين
() ح- اخرى

8- هل شركتكم تتلقى خدمات استشارية من مراجعكم الخارجى؟

(يتم ملئه من قبل موظفي الشركة فقط)

	نعم	1
	لا	2

القسم الثاني: الانطباع العام الحالي عن جودة المراجعة

من فضلك بين وجهة نظرك بخصوص الوضع الحالي لمستوى المراجعة في ليبيا وذلك بوضع دائرة على الرقم المناسب.

غير موافق بشده	غير موافق	غير متأكد	موافق	موافق بشده	فيما يتعلق بالمستوى الحالي لجودة المراجعة في ليبيا من وجهة نظري
5	4	3	2	1	(1) لوائح وتعليمات في القوانين الليبية لم تُدرج نصوصَ شاملة التي تُحسنُ في جودة المراجعة.
5	4	3	2	1	(2) يعتبر المستوى الحالي لجودة المراجعة في ليبيا اقل من المفترض
5	4	3	2	1	(3) المحاسبون الليبيون وجمعية المُدققين (إل أي أي أي) يتعبون دوراً مهماً في تطوير مهنة مراجعة حسابات ويُحسنون جودة المراجعة.
5	4	3	2	1	(4) إن منهج المحاسبة ومراجعة حسابات في نظام التعليم الليبي غير كافي لتدريب المُدققين.
5	4	3	2	1	(5) ادى ضعف مهنية المراجعين في ليبيا الى انخفاض مستوى جودة المراجعة
5	4	3	2	1	(6) تفضل معظم الشركات مكاتب المراجعة المرتبطة بمكاتب مراجعة اجنبية وتعتمد جودة المراجعة في ليبيا على نوعية مكتب المراجعة من حيث اذا كان مكتب مراجعة محلي او مكتب مراجعة محلي مرتبط بمكتب مراجعة اجنبي
5	4	3	2	1	(7) معظم مكاتب المراجعة في ليبيا ليس لها خلفية كافية عن خدمات المراجعة الجديدة كالخدمات التوكيدية والتقارير الالكترونية عبر الانترنت

القسم الثالث: عوامل جودة المراجعة

1- حجم مكتب المراجعة: انه لمن المعروف ان مكاتب الاربعة فى مهنة المراجعة يعملون فى ليبيا تحت اسماء مختلفة . بناء على ذلك , من فضلك بين وجهة نظرك بخصوص العبارات التالية وذلك بوضع دائرة على الرقم المناسب.

موافق بشده	موافق	غير متأكد	غير موافق	غير موافق بشده	من وجهة نظري
5	4	3	2	1	(1) حجم شركة المراجعة يرتبط بجودة المراجعة إيجابياً.
5	4	3	2	1	(2) مكاتب الاربعة الكبار فى مهنة المراجعة يُمكن أن تُبلِّغ عن الحالة المالية الحقيقية للزبائن بسهولة أكثر من الشركات الأخرى.
5	4	3	2	1	(3) تمتلك مكاتب الاربعة الكبار فى مهنة المراجعة قدرة اعلى على اكتشاف و اعلان التجاوزات لدى العميل
5	4	3	2	1	(4) تؤدي المكاتب الاربعة الكبار فى مهنة المراجعة اختبارات مراجعة قوية وفعالة اكثر من غيرها من مكاتب المراجعة
5	4	3	2	1	(5) تحقق المكاتب الاربعة الكبار فى مهنة المراجعة مستوى عالى من جودة المراجعة
5	4	3	2	1	(6) تحقق المكاتب المراجعة المحلية مستوى متدنى من جودة المراجعة
5	4	3	2	1	(7) تعتبر الشركات التي يتم مراجعتها بواسطة المكاتب الاربعة الكبار فى مهنة المراجعة اكثر جاذبية للمستثمرين
5	4	3	2	1	(8) تخطط المكاتب الاربعة الكبار فى مهنة المراجعة عملية المراجعة بفعالية اكثر من غيرهم من مكاتب المراجعة و اكثر قدرة على الحصول على نوعيات مختلفة من العملاء
5	4	3	2	1	(9) تعتبر الكاتب الاربعة الكبار اكثر استقلالية و احتمالية اصدار تقرير مراجعة متحفظ لدى المكاتب الاربعة الكبار فى مهنة المراجعة اعلى من غيرها

2- الخدمات الاستشارية: يوجد جدل واسع حول مسألة تقديم المراجع لخدمات استشارية, واثار ذلك على مستوى جودة المراجعة. بناء على ذلك, من فضلك بين وجهة نظرك بخصوص العبارات التالية وذلك بوضع دائرة على الرقم المناسب.

غير موافق بشده	غير موافق	غير متأكد	موافق	موافق بشده	من وجهة نظري
5	4	3	2	1	(1) يؤدي تقديم المراجع خدمات استشارية للعميل الى اكتساب المراجع مزيد من الخيرات في قطاع العميل و الى زيادة قدرة المراجع على الاطلاع على نظام العميل المحاسبي
5	4	3	2	1	(2) يؤدي تقديم المراجع خدمات استشارية للعميل الى اضعاف مستوى جودة المراجعة
5	4	3	2	1	(3) هناك فقط انواع محددة من الخدمات الاستشارية والتي تضعف مستوى جودة المراجعة في حالة تقديمها من قبل المراجع
5	4	3	2	1	(4) بهدف المنع من تقديم المراجع خدمات استشارية لعملائه الى تحقيق الاحساس باستقلال المراجع فقط
5	4	3	2	1	(5) يوفر تقديم المراجع خدمات استشارية للعميل بواسطة قسم مستقل مزيد من المصداقية للمراجع
5	4	3	2	1	(6) يؤدي تقديم المراجع خدمات استشارية للعميل الى اعتماد المراجع على ذلك العميل اقتصاديا
5	4	3	2	1	(7) يؤدي تقديم المراجع خدمات استشارية للعميل الى تقليل مخاوف المراجع من احتمالية تغييره من قبل العميل

3- المدة الزمنية لا ترتباط المراجع مع العميل: العلاقة بين المراجع والعميل دائما تحتاج الى رقابة دقيقة , مب فضلك بين وجهة نظرك بخصوص العبارات التالية وذلك بوضع دائرة على الرقم المناسب

غير موافق بشده	غير موافق	غير متأكد	موافق	موافق بشده	من وجهة نظري
5	4	3	2	1	(1) سياسة التعاقد الإلزامي تؤدي إلى زوال أي علاقة بين الزبون والمراجع
5	4	3	2	1	(2) إرتبط التعاقد الإلزامي بالجودة المراجعة إيجابياً.
5	4	3	2	1	(3) تضعف مدة التعاقد الطويلة بين المراجع والعميل من استقلال المراجع
5	4	3	2	1	(4) تزيد مدة التعاقد الطويلة بين المراجع والعميل من خبرة المراجع و تقليل ساعات عمل المراجع
5	4	3	2	1	(5) يجب ان يسمح فقط للشركات الكبيرة بالتعاقد لمدة طويلة مع المراجع الخارجي
5	4	3	2	1	(6) تؤدي سياسة التعاقد الإلزامي للمراجع الخارجي الى الاضرار بالمفهوم المهني للمراجعة و ضعف في المعلومات وطريقة تعرف المراجع على نظام العميل المحاسبي
5	4	3	2	1	(7) تؤدي سياسة التعاقد الاجباري للمراجع الخارجي الى التقليل المنافسة في سوق المراجعة و الى زيادة في اتعاب المراجعة
5	4	3	2	1	(8) المراجع سوف لن يُصبح تابع إقتصادياً بتحديد فترة مدة الخدمة المراجع.

4- المنافسة في سوق المراجعة:

غير موافق بشده	غير موافق	غير متأكد	موافق	موافق بشده	من وجهة نظري
1	2	3	4	5	(1) يعتبر سوق المراجعة في ليبيا شديد المنافسة
1	2	3	4	5	(2) جودة المراجعة قد تتأثر اذا كاتب المراجعة يشتغل في بيئة شديدة المنافسة
1	2	3	4	5	(3) جودة المراجعة قد تتأثر في حالة اجرا خصم في اتعاب المراجعة

5- اتعاب المراجعة: تلعب اتعاب المراجعة دورا ملموسا في تحديد جودة المراجعة ز بناء على ذلك،

من فضلك بين وجهة نظرك بخصوص العبارات التالية وذلك بوضع دائرة على الرقم المناسب

غير موافق بشده	غير موافق	غير متأكد	موافق	موافق بشده	من وجهة نظري
1	2	3	4	5	(1) ترتبط اتعاب المراجعة بجودة المراجعة ايجابياً.
1	2	3	4	5	(2) غالباً ما تقضى مكاتب المراجعة ذات الاتعاب المرتفعة ساعات مراجعة طويلة و غالباً ما تقدم مستوى مرتفع من جودة المراجعة
1	2	3	4	5	(3) تؤدي اتعاب المراجعة المحددة بواسطة جهة مستقلة الى تقديم مستوى مرتفع من جودة المراجعة
1	2	3	4	5	(4) تعتبر الزيادة في اتعاب عملية المراجعة ضرورية من اجل السماح بفحص حسابات العميل بدقة
1	2	3	4	5	(5) غالباً ما يحصل العميل الذي يدفع اتعاب مراجعة مرتفعة على تقارير مراجعة نظيفة
1	2	3	4	5	(6) غالباً ما يدفع العميل الذي يستلم خدمات استشارية من مراجعة الخارجى اتعاب مراجعة منخفضة
1	2	3	4	5	(7) غالباً ما تطلب المكاتب الاربعة الكبار في مهنة المراجعة اتعاب مراجعة مرتفعة و مكاتب المراجعة المحلية اتعاب مراجعة منخفضة
1	2	3	4	5	(8) يؤدي تحديد مستوى معين لاتعاب المراجعة (اعلى وادنى) الى تقديم مستوى مرتفع من جودة المراجعة

القسم الرابع: التطور المستقبلي لمستوى جودة المراجعة في ليبيا

من فضلك بين وجهة نظرك بخصوص العبارات التالية والمتعلقة بكيفية الرفع من مستوى جودة المراجعة في ليبيا وذلك بوضع دائرة على الرقم المناسب

غير موافق بشده	غير موافق	غير متأكد	موافق	موافق بشده	من وجهة نظري
5	4	3	2	1	(1) مكاتب المراجعة في ليبيا يجب ان تلتزم بمتطلبات جودة المراجعة الممتازة بشكل كفاء.
5	4	3	2	1	(2) يجب على نقابة المراجعين والمحاسبين القانونيين الليبية ان تتبنى المعايير الدولية للمحاسبة والمراجعة للرفع من جودة المراجعة ويجب فرض مزيدا من الاجراءات الصارمة على منح رخص مزاولة مهنة المراجعة
5	4	3	2	1	(3) يجب ان تكون هناك قوانين عقابية وتاديبية للمراجعين المخالفين للقوانين
5	4	3	2	1	(4) يجب ان يقتصر عمل مكاتب المراجعة على تقديم خدمات مراجعة فقط
5	4	3	2	1	(5) تحتاج الاجراءات واللوائح والانظمة الخاصة بمزاولة مهنة المراجعة الى مزيد من التطوير
5	4	3	2	1	(6) من المهم تحديد مستوى معين لاتعاب المراجعة (اعلى وادنى) من قبل هيئة مستقلة من قبل السلطات التنظيمية الليبية
5	4	3	2	1	(7) يجب ان تفصح مكاتب المراجعة عن نوعية وقيمة الخدمات الاستشارية المقدمة لعملائها في المراجعة و تفصح الشركات عن نوعية وقيمة الخدمات الاستشارية المستلمة من المراجع الخارجى
5	4	3	2	1	(8) النسبة المنوية من دخل الخدمات الاستشارية لمكاتب المراجعة يجب الا تتجاوز 25% من دخل مكت المراجعة من زبون واحد

Appendix 4: Interview Survey Questions in Arabic

أسئلة المقابلات الشخصية

القسم أ: معلومات شخصية

اسم المقابل: _____

اسم مكتب المحاسبة: _____

ممكن منفضك تخبرني قليلا على خبرتك؟ _____

القسم ب: جودة المراجعة في ليبيا

- هل تعتقد بأن جودة المراجعة في ليبيا ما زالت غير كافية؟

.....
.....
.....

- هل تعتقد ان نقابة المحاسبين والمراجعين القانونيين تلعبُ دوراً فعالاً لتحسين نوعية التدقيق؟

.....
.....
.....

القسم ج: المتغيرات المؤثرة في جودة المراجعة

1- حجم مكتب المراجعة

- هل تعتقدُ جودة المراجعة في ليبيا تُعتمدُ على نوعية مكتب المراجعة ومثال على ذلك: - شركة مراجعة محلية إنتسبت إلى شركة مراجعة أجنبية؟ إذا كان الأمر كذلك، ما المشاكل من ناحية جودة المراجعة بشركات المراجعة المحلية؟
- هل هناك أيّ اختلاف في جودة المراجعة بين الشركات الاربع الكبار والشركات الأخرى؟

1. تزوّد مستوى أعلى من جودة المراجعة

2. اضرار بالسمعة.

3. الإستقلال.

4. أكثر جاذبية وقوة للمستثمرين والدائنين

5. قاوم ضغط إدارة

في أيّ المنظور؟ كمّ هذه الحالة تُحدثُ

2- الخدمات الاستشارية:

- هل تعتقد ان الخدمات الاستشارية تؤثر او تدعم جودة خدمات المراجعة في ليبيا ؟

.....
.....
.....

- هل تُعتقدُ بأنّ تزويد الخدمات الاستشارية (إن أي إس) من قبل قسم منفصل يعطي مصداقية أكبر للمراجعة؟

.....
.....
.....

3- المدة الزمنية لتعاقد مع المراجع:

- هل تُعتقدُ بأنّ الدوران الإلزامي للمراجع يرتبط جودة المراجعة إيجابياً؟

.....
.....
.....

- هل تُعتقدُ بأنّ مدّة المراجعة الطويلة المدى تُضعفُ إستقلال المراجع؟ إذا كان الأمر كذلك، لماذا تُعتقدُ هذا؟

.....
.....
.....

4- مستوى المنافسة في سوق المراجعة:

- في رأيك، إلى أي مدى المنافسة الشديدة لها تأثير في جودة المراجعة؟

.....
.....
.....

5 - اتعاب المراجعة:

- هل تعتقد بأن اتعاب المراجعة يرتبط بجودة المراجعة ايجابياً؟

.....
.....
.....

- هل تعتقدان مكاتب المراجعة الأربعة الكبار تتقاضى أجور التدقيق الأعلى من غير الأربعة الكبار والاتعاب العالية ترتبط بالجودة عالية؟

.....
.....
.....

القسم د: التحسينات في مستوى جودة المراجعة

- ماذا يُغيّرُ الأشياءَ نحو الأحسن، من ناحية تحسين المراجعة وتحسّنُ جودة المراجعة في ليبيا؟ وماذا يكون دور النقابة في ذلك التطوير؟

.....
.....