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Audit Performance and Practicing Environment Reform:  
Audit Practicing Environment in Egypt

DOCTORAL DISSERTATION

Supervisor: Prof. Dr. Iván Belyácz

Pécs, 2015

## **Declaration of Originality**

I, the undersigned, solemnly declare that this doctoral dissertation is the result of my own independent research and was written solely by me using the literature and resources listed in the Bibliography.

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Khaled Omar Abbas

Kuwait, 1.03.2015

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## **Abstract**

This thesis presents a study to identify and measure the interrelationship between proposed audit environment's main factors, in order to present a suggested model for audit fundamentals' reform in Egypt. This model will increase the professional auditors' and practicing regulatory bodies' roles. Due to the globalization of capital markets, the audit environment becomes more complex and includes many interactive relationships between its main fundamental factors. Recent accountability failures in the United States and other countries raised the fact that the accounting and auditing professional practicing environment needs to be reformed, modernized, and expanded.

Despite the increased global attention to the importance of audit practice reforms, there are a limited number of academic researches that discussed the practicing environment changes and their affects on auditors' responsibility and operating process.

An extensive review of the literature revealed a strong relationship between audit practicing and recent financial failures, as well as the subsequent global expansion of practicing reforms.

This thesis makes an important contribution to the audit-practicing global harmonization through developing a theoretical Conceptual Practicing Environment model that has been created and follows a deductive approach, and primary data questionnaires collected from the designated practitioners in different local big audit firms. Data was analyzed according to their descriptive properties and underlying correlation structure. Several principal components were derived from these analyses, which were used in hypothesis testing, in order to examine the interrelationships between the factors associated with audit-practicing environment.

Furthermore, implications for academics and practitioners are drawn that indicate the relevance and applicability of this research to audit practice reforms. Research limitations for possible future research are set out. The thesis is organized into eight chapters, which are entitled in the following order: chapter one introduces the overview and the background of the study, chapter two introduces a review of related literatures, chapter three presents an analysis of the relationship between audit practice and recent financial market failures, chapter four examines different internal and external audit-practicing environment variables, chapter five discusses the current environment of audit practice in Egypt, chapter six proposes the suggested factors that affect the efficiency of the audit-practicing environment, chapter seven analyzes the correlation and multiple regressions based on the questionnaire and empirical

tests of the hypothesis, and chapter eight provides suggestions for Egypt's local practice reforms.

The magnitude of each variable in the practicing environment will be differentiated from one country to another based on the local culture and influence power of environment of different variables. The thesis confirmed that the current Egyptian local practice environment is classified as a dormant, complex, and uncertain environment that needs major reforms in order to increase its practice organizations effectiveness. Also, empirical research results raised a consensus between the selected sample answers about the importance of increasing professional accountants' and auditors' technical and judgmental capability, in addition to the necessity of increasing the non-governmental organizations' subscriptions in developing and managing the practicing profession.

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## Table of Contents

<i>Declaration of Originality</i> .....	<i>i</i>
<i>Acknowledgements</i> .....	<i>ii</i>
<i>Abstract</i> .....	<i>iii</i>
<b>Table of Contents</b> .....	<b>v</b>
<i>List of Figures</i> .....	<i>x</i>
<i>List of Tables</i> .....	<i>xi</i>
<b>Chapter 1: Context and Purpose of the Study</b> .....	<b>1</b>
<b>1.1 Introduction</b> .....	<b>1</b>
<b>1.2 Problem Identification and Research Objectives</b> .....	<b>4</b>
1.2.1 Research Aims and Objectives.....	5
1.2.2 The Main Objectives of the Proposed Thesis.....	6
1.2.3 Thesis Contribution and Motivation.....	6
<b>1.3 Thesis Hypotheses</b> .....	<b>7</b>
<b>1.4 Limitations of the Thesis</b> .....	<b>8</b>
<b>1.5 Structure of the Thesis and Order of Presentation</b> .....	<b>8</b>
<b>Chapter 2: Review of Literatures</b> .....	<b>11</b>
<b>2.1. Audit and Reporting Quality</b> .....	<b>12</b>
<b>2.2. Audit Social Values and Ethical Trust</b> .....	<b>15</b>
<b>2.3. Auditors and Audit Firms Professions</b> .....	<b>19</b>
<b>2.4. Legal Local Enforcement versus International Standards</b> .....	<b>22</b>
<b>2.5. Professional Practicing Environmental Culture</b> .....	<b>23</b>
<b>2.6. Professional Practicing Environmental Characteristics</b> .....	<b>25</b>
<b>Chapter 3: Audit Practicing and Financial Market Failures</b> .....	<b>35</b>
<b>3.1 Financial Crisis and Scandals</b> .....	<b>36</b>
3.1.1 Enron Scandal .....	36
3.1.1.1 Enron Anecdotes and the Falling Trip.....	37
3.1.1.2 Audit Professions and Enron Failure .....	38
3.1.1.3 Sarbanes-Oxley Act (SOX) .....	41
3.1.2 Earnings Management and Creative Accounting Concepts .....	42
3.1.2.1 The Concept of Earnings Management.....	43
3.1.2.2 Reasons Behind Spreading of Creative Accounting .....	45
3.1.2.3 The Auditors' Role in Creative Accounting and Fraud.....	46
3.1.3 The Financial Crisis .....	49
3.1.3.1 Reasons beyond the 2008 Global Financial Crisis Start up .....	49
3.1.3.2 Credit Rating Agencies' Role in the 2008 Global Financial Crisis .....	52
3.1.3.3 Auditors' Role in the 2008 Global Financial Crisis .....	54
<b>3.2 Audit Quality and Practicing Environment</b> .....	<b>57</b>
3.2.1 Auditors and Quality of Financials Reporting.....	57
3.2.1.1 Financial Reporting and Audit Quality.....	57
3.2.1.2 Auditor Role in Recent Financial Scandals .....	59

3.2.1.3	Audit Firms Subsequent to the Financial Scandals.....	61
3.2.2	Audit Practicing and Ethical Environment.....	63
3.2.2.1	Ethics Environment and Morality Fundamentals.....	64
3.2.2.2	Conflict of Interests and Auditor Independency .....	65
3.2.2.3	Code of Ethics .....	66
3.2.3	Corporate and Audit Practicing Governing Environment .....	67
3.2.3.1	Practicing Environment and Expectations Gap .....	67
3.2.3.2	Corporate and Audit Professions Governance .....	69
3.2.3.3	Audit Practicing Legalization versus Non-legalization .....	70
<b>Chapter 4: Audit Practicing Internal and External Environment.....</b>		<b>74</b>
<b>4.1</b>	<b>Audit Practicing Internal Environment .....</b>	<b>77</b>
4.1.1.	Audit-Practicing Organizations' Objectives .....	78
4.1.2.	Audit-Practicing Organizations' Structure .....	81
4.1.3.	Practicing Organizations' Environmental Culture .....	85
<b>4.2</b>	<b>Audit-Practicing External Environment .....</b>	<b>91</b>
4.2.1	External General Environment.....	94
4.2.1.1	International and Local Regulators Context .....	95
4.2.1.2	International and Local Economic Context .....	95
4.2.1.3	International and Local Social Context.....	96
4.2.1.4	International Practicing Standards .....	97
4.2.2	Specific External Environment .....	98
4.2.2.1	Local and International Audit Clients.....	98
4.2.2.2	Local and International Competitors .....	99
4.2.2.3	Local and International Regulators.....	100
4.2.2.4	International Practicing Standard Setters.....	100
4.2.3	Environmental Uncertainty .....	101
<b>Chapter 5: Current Environment of Audit Practicing in Egypt .....</b>		<b>107</b>
<b>5.1</b>	<b>Laws and Regulations .....</b>	<b>110</b>
5.1.1	Governmental Regulatory Bodies and Laws .....	110
5.1.2	Companies' Law .....	112
5.1.3	Banking Law and Capital Market Law .....	113
<b>5.2</b>	<b>Non-Governmental Associations and Practicing Organizations .....</b>	<b>114</b>
5.2.1	Non-Governmental Associations “ESAA & Syndicate Accounts Unit” .....	114
5.2.2	Audit-Practicing Organizations & Audit Firms in Egypt .....	115
5.2.3	Practicing Auditors in Egypt and their Qualifications.....	116
5.2.4	Accounting and Auditing Standards Committee .....	117
<b>Chapter 6: Proposed Factors that Affect the Audit Practice Environment.....</b>		<b>120</b>
<b>6.1</b>	<b>Local and International Non-Governmental Audit-Practicing Organizations.....</b>	<b>123</b>
6.1.1	Non-Governmental Organizations .....	123
6.1.2	Non-governmental International Audit-Practicing Organizations.....	125
6.1.2.1.	International Organization of Securities Commissions (IOSCO) .....	127
6.1.2.2	International Financial Reporting Standards (IFRS) Board and Committees .....	128
6.1.2.3	International Federation of Accounts (IFAC) .....	129
<b>6.2</b>	<b>Audit Firms/Private Practicing Organizations .....</b>	<b>131</b>
6.2.1	Audit Firms' Performance and Efficiency .....	133
6.2.2	Audit Firms' Size and Internal Ethical Values .....	134
6.2.2.1.	Audit Firm Size .....	134
6.2.2.2	Audit Firm Internal Ethical Values.....	135
6.2.3	Audit Firm General Internal Regulations .....	136
6.2.3.1	Audit Firms Internal Quality Regulations.....	137
6.2.3.2	Audit Firm Staff Regulations.....	138

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## Appendices

---

6.2.4	Governmental Regulatory Bodies and Laws .....	138
6.2.5	Auditors' Characteristics .....	143
6.2.5.1	Auditors' Ethical Values .....	144
6.2.5.2	Auditors' Independency .....	146
6.2.5.3	Auditors' Competency .....	147
<b>Chapter 7: Empirical Research .....</b>		<b>151</b>
<b>7.1</b>	<b>Details of Survey Questions .....</b>	<b>152</b>
7.1.1	Part (1): The effect of non-governmental professional associations on the auditing environment ..	152
7.1.2	Part (2): The effect of the professional organizations practicing on the auditing environment.....	153
7.1.3	Part (3): The effect of the governmental authorities and laws on the auditing general environment ..	154
7.1.4	Part (4): The effect of the auditors' qualification on the audit practicing environment. ....	156
7.1.5	Part (5): The effect of the interested parties on the audit practicing environment.....	157
<b>7.2</b>	<b>Sample Construction and Results .....</b>	<b>158</b>
7.2.1	Sample Construction .....	158
7.2.2	Sample Results .....	160
<b>7.3</b>	<b>Hypotheses and Analyses .....</b>	<b>170</b>
7.3.1	First Hypothesis .....	170
7.3.2	Second Hypothesis .....	172
7.3.3	Third Hypothesis .....	173
7.3.4	Fourth Hypothesis.....	175
7.3.5	Fifth Hypothesis .....	176
<b>7.4</b>	<b>Empirical Analysis Discussion and Results Conclusion .....</b>	<b>185</b>
7.4.1	Empirical Analysis .....	186
7.4.1.1	Professional Organizations Internal Environment (correlation and Regression Analysis) .....	187
7.4.1.2	External General Environment Correlation and Regression Analysis .....	191
7.4.1.3	KMO (Kaiser-Mayer-Oklin) and PCA (Principle Component Analysis) Test .....	194
7.4.1.4	KMO and PCA Results Discussion .....	196
7.4.1.5	External General Environment Correlation Analysis .....	200
7.4.2	Empirical Discussions .....	201
7.4.3	Empirical Results and Conclusion .....	203
<b>Chapter 8: Suggested Practicing Reform in Egypt.....</b>		<b>207</b>
<b>8.1</b>	<b>Practicing General Reform Conceptual Framework .....</b>	<b>207</b>
8.1.1	Practicing General Reform Procedures .....	207
8.1.2	Enhancing the Role of Other Regulatory Agencies/Ministry of Finance .....	209
<b>8.2</b>	<b>Developing the Quality of Audit-Practicing Organizations.....</b>	<b>210</b>
8.2.1	Developing the Role of Egyptian Society of Accountants and Auditors (ESAA).....	210
8.2.2	Improving Audit Firms' Quality Management.....	211
8.2.2.1	Leadership Responsibilities for Quality Within the Firm .....	212
8.2.2.2	Ethical Requirements .....	212
8.2.2.3	Acceptance and Continuation of Clients' Relationships and Specific Engagements.....	212
8.2.2.4	Human Resources .....	212
8.2.2.5	Monitoring .....	212
8.2.3	General Conclusion .....	212
<b>References.....</b>		<b>214</b>
<b>Supplementary References.....</b>		<b>240</b>
<b>General Appendices .....</b>		<b>251</b>

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**Appendices**

<b>Appendices</b>		<b>Page</b>
Appendix 1	<b>Professional Certification .....</b>	160
Appendix 2	<b>Current Job .....</b>	160
Appendix 3	<b>Work Field .....</b>	160
Appendix 4	<b>The Effect of Non-governmental Professional Associations on the Auditing Environment</b>	161
Appendix 5	<b>The Effect of the Professional Organizations Practicing Auditing on the Auditing Environment</b>	162
Appendix 6	<b>The Effect of the Governmental Authorities and Laws on the Auditing General Environment</b>	163
Appendix 7	<b>The Effect of the Governmental Authorities and Laws on the Auditing General Environment</b>	164
Appendix 8	<b>The Effect of the Governmental Authorities and Laws on the Auditing General Environment</b>	165
Appendix 9	<b>The Effect of the Auditors' Qualification on the Audit Practicing Environment</b>	166
Appendix 10	<b>The Effect of the Interested Parties on the Audit Practicing Environment</b>	167
Appendix 11	<b>The Effect of Non-governmental Professional Associations on the Auditing Environment</b>	168
Appendix 12	<b>The Effect of the Governmental Authorities and Laws on the Audit Agreement Scores</b>	171
Appendix 13	<b>The Effect of the Professional Organizations Practicing Auditing on the Auditing Environment Agreement Scores</b>	173
Appendix 14	<b>The Effect of the Auditors' Qualifications on the Audit Practicing Environment Agreement Scores</b>	174
Appendix 15	<b>The Effect of International Professional Associations on the Audit Practicing Environment Agreement Scores</b>	175
Appendix 16	<b>The Effect of the Non-governmental Organizations, and Laws on the Auditing General Environment Agreement Scores</b>	177
Appendix 17	<b>The Effect of the Governmental Authorities and Laws on the Auditing General Environment Agreement Scores</b>	178
Appendix 18	<b>The Effect of Non-governmental Professional Associations on the Audit Practicing Environment Agreement Scores</b>	179
Appendix 19	<b>Summary of Professional Organizations Internal Environment Correlation and Regression Analysis</b>	188
Appendix 20	<b>Summary of External Practicing Environment Correlation, and Regression Analysis</b>	192
Appendix 21	<b>Summary of Total Variance Explained</b>	195
Appendix 22	<b>Monte Carlo PCA, Random Parallel Analysis</b>	196
Appendix 23	<b>Component Correlation Matrix</b>	196
Appendix 24	<b>Pattern Matrix Analysis</b>	198
Appendix 25	<b>Structure Matrix Analysis</b>	199

## *Appendices*

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Appendix 26	<b>Empirical Analyses Observations Summary</b>	204
Appendix 27	<b>Ranking Base of Practicing Environmental Variables</b>	204

## **List of Figures**

<b>List of Figures</b>	<b>Page</b>
Figure 1	<b>Stakeholders' Groups</b> 30
Figure 2	<b>External-Specific and General Environmental Variables</b> 94
Figure 3	<b>Conceptual Practicing Environment Design: Internal and External Environment Dimensions</b> 105
Figure 4	<b>Non-Governmental Practicing Organizations</b> 125
Figure 5	<b>International Non-Governmental Organization</b> 127
Figure 6	<b>Audit Firms' Environmental Variables</b> 132
Figure 7	<b>Governmental Regulatory Bodies/Organizations</b> 141
Figure 8	<b>Laws and Regulations</b> 143
Figure 9	<b>Auditors' Characteristics and Ethical Values</b> 144
Figure 10	<b>Scree Plot</b> 195

**List of Tables**

<b>List of Tables</b>		<b>Page</b>
Table 1	<b>Characteristics of Mechanistic Structures</b>	84
Table 2	<b>Culture Models Classification</b>	88
Table 3	<b>Culture Types Classification</b>	89
Table 4	<b>Project GLOBE Classification of Egyptian's Societal Cultures</b>	107
Table 5	<b>Hypotheses Analysis Summary Results</b>	180
Table 6	<b>Characteristics of Practicing Local Environment</b>	202

# **Chapter 1**

## **Context and Purpose of the Study**

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## **Chapter 1: Context and Purpose of the Study**

### **1.1 Introduction**

The emergence of international capital markets requires high cooperation between foreign and local regulators, besides capital providers. This cooperation will support funding growth, invent new ways to manage them, reduce the complexity of the current globalized business environment, and ease the capital flows between borders. In order to increase the efficiency of capital markets, businesses need to unify the processing of international financial transactions through the use of new accounting and assurance methods, such as generally accepted accounting and auditing standards, which simplify the recording of local and foreign economic deals (ICAA, 1998). In particular, consider the frequent international spread of companies' financial securities, and the complicated requirements of multi-markets securities listings, which make the companies subject to both local and foreign regulations. Most financial researches present the necessity of markets efficiency, which is essential not only in wealthy countries, but also in undeveloped nations, as markets that work with efficient and transparent systems will be globally recognized.

Current changes in global businesses set a new paradigm for the audit practicing environment, which requires an integrated international harmonization between audit-practicing regulations, taxation rules, corporate laws, and accounting standards. International harmonization represents a strong challenge, as it is hard to establish globally acceptable accounting tools that enable different governments to deal with their local and international unique specifications. The new paradigm shifted the communities' behavior to be more engaged with accounting applications, financial markets concerns, and relaying more on financial reports as the main source for their investments' decisions. These changes, in addition to the technology reevaluation, and the increase of strong, connected global financial environments,

created a new competitive organizational market structure, and led to a more challenging environment for both local and international audit firms, which forced auditors to expand their range of business services beyond the traditional assurance and tax advices (**Epstein & Geiger, 1994**). Additionally, these changes increased the international pressures for imposing professionalism competency, and global strategic professions' mindset that support the creation of global ethical culture, knowledge, skills and social rules for both audit firms and audit-practicing institutions. This approach will enable audit firms to effectively meet their public responsibilities, and recover their lost reputations, which were obviously damaged because of the recent audit failures in the United States and many other countries.

Audit credibility improvement requires reliable processes of financial reporting at all points, along with the information management supply chain, in order to reduce the auditor litigation risk. Also, it requires honesty from both corporate management and boards of directors, as well as effective subscriptions of other participants in the reporting processes, such as auditors, lawyers, banks, regulators, standard setters, credit rating agencies, and analysts (**IFAC, 2003**).

Recently, accounting and auditing became part of the political lobbying game. Political lobbying can be forced by government, or any of the negatively affected beneficiaries, such as companies' management, executives, investors, regulatory bodies, associations, and any other parties that have the power to influence decision makers. Accordingly, it is essential to create a strong ethical culture in audit-practicing businesses by establishing practice governing rules, policies, and increasing peers to support moral practice and ethical values (**Piotroski & Srinivasan, 2008**). Accordingly professions start to focus more on developing a proper code of ethics, corporate governance, and strategic directions guidance. The current structure of global economies is supporting the International Financial Reporting Standards (IFRS), and International Auditing Standards' (IAS) role in providing high-quality financial information, which is increased due to the recent accounting and financial

failures, such as Enron, which encouraged most of the developed countries to legalize the forms and competences that support mandating these international standards **(Hegarty et al., 2004)**. On the other hand, enhancing organizations' transparent practices and financial quality, through proper disclosures, can reduce their cost of capital and increase their shares' liquid market value, as well as enhance the capital markets performance and the overall economy.

Definitely, the business world's quick environmental changes and globalization led to a shift in the practicing environment, and impacted the auditors' daily practice operations. The inefficient practicing environmental structure associated with governmental passion to deregulate audit practicing and credit rating services hinders the audit basic role of any financial signaling system, and also turned the practicing environment and audit firms into oligopoly profit seekers that tried their best to cover any crisis indicators and protect their interests. Accordingly audit practicing is quite simply at a truly critical point in the history of professions, which requires an immediate global reform to strengthen, modernize, and promote adherence to high-quality accounting and auditing standards that encourage knowledge exchange, in addition to developing a strong international practicing environment that follows integrated auditing best practices, and putting public interests before personal interests **(Previts, 2005)**.



## **1.2 Problem Identification and Research Objectives**

Developments in the global and Egyptian economy have taken on a more significant role, and challenge, for the auditing and accounting services, which are essential for businesses operating in a free market economy. Today, thousands of Egyptian audit firms, big and small, have to come to terms with the stringent standards that they must adhere to. Currently, there is a scarcity of experienced auditors in Egypt because of lack of education and training, the absence of a strong independent counsel (to grant licenses, designations, and enforce training and continuous education), and the lack of competitive advantages in the auditing profession. Egyptian auditors are not required to follow any code of ethics in line with the IFAC codes. This deficiency is accompanied by a prevalence of the closely held companies and the absence of rules associated with appointing, or changing, auditors.

Audits have recently become more important than in the past due to the globalization of capital markets. Moreover, the audit environment has become more complex and includes many interactive relationships between its main fundamental factors. There are no specific identifications for these factors that have the main effects on the audit environment efficiency. In this thesis, we will try to measure the interrelationship, importance, and effect of these proposed main factors on the audit environment, in order to present a suggested model for audit fundamentals reform in Egypt. This will be measured through the use of the empirical research and quantitative survey.

The draft of the new Egyptian Accounting Practice Law has been under discussion for more than five years. The delay in finalizing a new Audit Practice Law has stalled efforts to improve accounting and auditing practices. Also, the lack of knowledge and guidelines regarding the application of Egyptian and international standards restricts the preparation of financial statements in compliance with these standards. On the other hand, educational quality suffers from a lack of modern curriculums and too few teachers for too many students. The accounting curriculum

needs to be updated, as undergraduate-level accounting and auditing courses only focus on elementary topics and application of standards, but do not include international standards as a detailed practice subject. As a result, the knowledge gap of practitioners is increased by the absence of the continuous education system.

The current practicing registration rules do not require adequate practical knowledge to the novices to perform the audit. Furthermore, The Egyptian audit practitioners are not required to follow any modern code of ethics in line with the IFAC Code of Ethics for Professional Accountants. The current Egyptian Standards on Auditing only addresses the presentation of the final audit report, which may improve the appearance of the final product without necessarily improving the entire process of auditing.

### **1.2.1 Research Aims and Objectives**

Recent accountability failures in the United States and other countries have led to bankruptcies and restatements that harmed countless shareholders, employees and retirees. This also increased awareness about accounting and auditing professions needing to be reformed, modernized, and expanded.

Accountants and auditors must integrate best practices into their daily routines, and must also put the public interests before their personal interests by doing what is ethically right and not just legally permissible. Additionally, they must be concerned about both fact and appearance, especially when it comes to independence issues.

Audit practicing is, quite simply, at a truly critical point in the history of the profession. The community is totally engaged in accounting and is dependent upon financial reports. This requires continuous efforts to strengthen the worldwide accountancy and auditing profession, which contributes to the development of strong international economies, by establishing and promoting adherence to high-quality

professional standards, and encouraging and facilitating professional global development and exchange of knowledge and best practices.

### **1.2.2 The Main Objectives of the Proposed Thesis**

Presenting a model that could be used to reform the Egyptian audit environmental variables, which will increase the professional auditors' and practicing regulatory bodies' roles through the following:

- 1- Providing institutional structures to permit the auditor to maximize their self-interest in a publicly interested way, which may lead to an explicit covenant to serve the public interests;
- 2- Increasing the local professional body hegemonic role in audit practicing constituted ideologies, as well as, enhancing the coercive and consensual approaches adopted by the government;
- 3- Measuring and increasing the practicing environment fundamental factors interactions based on the type of political, social and cultural setting. This view of the perspective is pivotal to the overall auditing practicing environment efficiency that provides a useful lens to appreciate auditing and non-auditing services;
- 4- Reshaping of audit firms practicing methodologies, as well as the formation of new moral ideologies; and
- 5- Increasing the professional auditors' practicing ability to identify and diagnose problems, through continuous developing training, technical education, and supports that will enhance audit professions' reputation in both and local prospects.

### **1.2.3 Thesis Contribution and Motivation**

The main law governing the Egyptian professional accountants and auditors, particularly in the private sector, is the Accounting Practice Law 133/1951 and its amendments, which are considered out of date by most practitioners. The Company Law does not cover accounting and auditing standards, but requires that external audits be conducted in compliance with the Accounting Practice Law 133/1951. There is a gap between the Egyptian's law and the practice's compliance with accounting and auditing standards. Egyptian professional standards for accountants

and auditors need to be improved by raising the quality of public university education and by introducing a professional qualifications examination.

The basic ground rules of the Egyptian political system have prevented necessary legislative reform. As such, this faulty legislative system has institutionalized a corrupt set of structures that led to biased decisions and occasionally outright corruption. Moreover, current local laws created an inefficient, unethical, and wasteful system. The auditor's independence in Egypt is strongly affected, which is aggravated by the lack of separation between audit and consultancy services provided by the auditor.

The thesis helps to develop the local audit practicing environment, which is expected to result in significant effects on the public auditing profession and practicing role. Also, it may create new balance for political forces, and increase the creditability of public audit services.

Profession reforms will support the auditor's position in the country's policy making through establishing a governmental relations module that enables the local standard-setting bodies to have a voice in issues affecting the local accounting professions.

### **1.3 Thesis Hypotheses**

- Updating of practicing law will partially participate in developing audit environment;
- Increasing the efficiency of audit-practicing environment requires structure of all environment fundamental factors / variables at the same time but not with the same degree of importance;
- Implementing of practicing firm's quality-control procedures will enhance the efficiency of audit-practicing environment faster than other fundamental factors / variables;
- International environment fundamental factors / variables will have a positive effect on practicing environment reform; and

- The primary factors that are expected to have the most important effect in practicing environment reform will be the governmental regulatory bodies and non-governmental associations.

### **Model**

The model will help with the following:

- Developing practicing licensing qualifications, and auditors' competence and independence; and
- Increasing the efficiency of the current practicing society, and the proposed new board of accountancy.

## **1.4 Limitations of the Thesis**

The thesis has to be examined in light of its limitations. This thesis is an explanatory study; however, we tried to present it in a comprehensive manner. Most of the related subject studies, mainly in the audit regulation field, are focusing on the audit technical aspects. There are a limited number of audit studies that tried to investigate audit environmental variables, or measure their expected effects on the general audit-practicing environment. We tried to structure the basis for building a model that can be used by future researchers to construct an initial theory that measures the relationship between audit-practicing different environmental variables and their effects on audit services. We also recommend that future studies in the same field need to focus on developing an integrated theory in the field of practicing environment development.

## **1.5 Structure of the Thesis and Order of Presentation**

Chapter Two introduces a review of related literatures to present a background introduction.

Chapter Three presents an analysis of the relationship between audit practice and recent financial market failures. The chapter considered the effect of creative accounting tools, Enron scandal, and the recent global financial crisis on the governing audit-practicing environment and ethical values.

Chapter Four examines different internal and external audit-practicing environment variables. It describes the effect of internal environment factors on practice organization objectives, structure, and governing culture. Also, it considers the effect of external environmental factors, such as regulators, economic, social, and practicing standards. The chapter also considers the classification of environmental uncertainty.

Chapter Five discusses the Current Environment of Audit Practice in Egypt by reviewing business laws currently in use, different governmental, non-governmental regulatory bodies, and other audit practicing organizations.

Chapter Six proposes the suggested factors that affect the efficiency of the audit-practicing environment. These factors include Non-Governmental local and international organizations, regulatory bodies, audit firms' management, and auditors' characteristics.

Chapter Seven analyses the correlation and multiple regressions based on the questionnaire and empirical tests of the hypothesis. It also discusses the statistical analysis and research results.

Chapter Eight provides suggestions for Egypt's local practice reforms through developing a new conceptual framework and practicing quality measurements. Also, it concludes the end results related to Egypt's local practicing environment.

**Chapter 2**  
**Review of Literatures**

## Chapter 2: Review of Literatures

Economic recovery is an ongoing process that requires support and collaboration from the private and public sectors, including both accounting and audit professions. Audit function is basically rooted in control and credibility, while audit credibility is gained from auditors' independence, objectivity, competence, and the ability to obtain and assess quality of management information. The first professional auditors' negligence suit was in 1890, which shifted audit profession techniques and methods to the court's scrutiny (**Roy, 1999**). During the last decade, there were plenty of severe criticisms and litigations against audit professions; accordingly, the development of accounting science became a hot research topic that focused on exploring professional accounting techniques, roles, and systems. The recent changes in economic behavior, market mechanisms, and market liberation are associated with increasing numbers of financial scandals, frauds, and collapses. These changes forced accounting researchers to broaden the scope of accounting research to focus more on accounting aspects that connected to economic development, political phenomena, environmental, and social practicing.

As a consequence of the recent financial failures, which were followed by markets crashes and punitive legislations, the investors' faith in the integrity of the capital market had been deteriorated; accordingly, the international accounting and auditing scene has been dramatically changed (**Ronen & Yaari, 2008**). The scene is currently more focus on globalization of professional standards and regulations in order to increase the efficiency and effectiveness of the sophisticated global capital market. The current free capitalist economic cycles depend on many complex environmental external variables, which increased the necessity of having reliable financial information tools to manage the relationship between the companies, their different stakeholders, and financial markets vehicles. This situation increased the potential magnitude of booms and busts risks that may result if financial markets



crashed (**Rajan & Zingales, 2003**). Theoretically, a reliable and effective accounting standards system, which is the bedrock of any commercial enterprise, can support the stability of economic capitalism (**American Assembly Report, 2003**). However, in practice accounting and auditing standards did not help in avoiding the 2008 financial crisis.

### **2.1. Audit and Reporting Quality**

Auditors used to serve as detectives for companies' owners, check accounts, manage books, and report back their findings. Owners usually use these reports to monitor their agents. Historically, the auditor's role expanded to include certifying their clients' disclosed information to third parties, which shifted the user's focus into the auditor's approval of the information, not the assessment of its quality. Today, auditors are required to report their clients' proper accounting based on the pre-set standards criteria; additionally, auditors are required to consider public interests when issuing their audit reports. The auditor's current main role has been changed to certify the financial information for disclosure to the investing public at large (**Shapiro, 2005**). **Pendergast (2005)** argues that due to the current expanded financial markets, public practicing has become a keystone for markets efficiency, as auditors' reports are serving millions of publically traded and private companies, governmental regulatory agents, and nonprofit organizations. This argument shows the necessity of setting up new regulations to broadband the auditor main responsibility towards protection of public interests. **Holmstrom and Kaplan (2003)** debate that the last decade's accounting failures triggered significant accounting regulations and procedural reforms, which increase the financial reporting quality, specifically in countries that have restricted investor protection laws, such as the Sarbanes-Oxley Act (SOX). Also, the financial failures raised a strong academic argument regarding the accounting role in the 2008 financial crisis. Some academics such as **Hildyard (2008) & Arnold (2009)** insisted on the accounting responsibility of the financial

crisis. They debated that accounting improper disclosures and inefficient methodologies failed in capturing or limiting the organizations' policies' underlying financial risks. While other academics, such as **Humphrey et al. (2009)**, blamed banks, financial institutions, insurance companies, credit rating agencies, and regulators. **Barth and Hutton (2004)** argue that many analysts failed to anticipate management earnings associated with the high financial accruals; accordingly, they did not revise their forecasts. Therefore, accounting may be an innocent victim by standards, as accounting is a mere recorder of events, while the stability of financial markets rests on bankers, analysts, and regulators. Despite the researchers' debate, it is still obvious that both accounting and auditing profession are responsible for certain degree of 2008's financial crisis. However, we need to consider that there were also other variables that played significant roles in firing the crisis, such as inappropriate laws, regulations, absence of regulators controlling role, ineffective governmental monitoring tools, as well as, the weak moralities of different involved parties.

Typically, there are two systems to monitor public companies' performance: the first is internally applied through using accounting standards, while the second is externally managed through the markets' regulators. Market regulators have the essential legally protected tools that enable them to limit organizations' boards and management discretions, monitor companies released significant information, take any necessary actions to protect public interests, and impose of specific financial reporting standards (**Gordon, 2003**). Use of clearly defined financial standards can prevent, to some extent, the earnings management techniques. **Arya et al. (2003)** argue that the restricted accounting standards, such as IFRS, may stop management earnings accounting techniques, but they will encourage management to search for new creative accounting tools without considering any long-term fraudulent effects associated with these tools. **Kedia and Philippon (2005, p. 1)** argue that fraudulent accounting has a negative effect on economic resources allocation, as it creates direct income for insiders rather than shareholders. They also conclude that "In equilibrium

situation bad managers invest and hire in a high patterns that lead to inefficient resources allocation." However, **Vona (2008)** argues that auditing standards require the auditor to investigate fraud, and unfortunately the standards do not provide clear tools to detect types of fraud, which usually starts out small through assuming legitimate managing earnings, and ends up as a massive financial fraud. **Van-Tendeloo and Vanstraelen (2005)** conclude that clear and rigid accounting standards will not prevent earnings management, unless supported by sufficient legal systems, regulations, oversight bodies, and auditors' commitments.

Other researchers tried to investigate variations between legal systems and their associated culture. **Jaggi and Low (2000)** argue that differences in legal systems are the most important explanatory culture variable; however, it is not overtly obvious whether legal systems dominate national culture or whether they are complementary. **Hope (2003)** examined the magnitude of legal systems and national culture in explaining differences in annual report disclosures, and he concludes that the cultural dimensions behave differently across legal regimes; he also suggests that researchers should consider culture as an important aspect in accounting researches. Accordingly, he considered external culture as the most significant attribute of the financial reporting environment. While other researchers considered legal origin as a principal variable in understanding variations between financial reporting and disclosures behavior culture (**Ball et al., 2000**). **Hegarty et al. (2004)** debate that the main forces for audit and financial quality are associated with the power of the domestic regulatory regimes, rather than professional networks or their members. **Boyd (2004)** debates that auditing practicing changes and evolution lie in the hands of regulators and legislators' power, as any regulator's significant changes will not be effective without major changes in both the audit firms' culture and the surrounding environmental variables.

Despite the researchers debate around the importance of setting up detailed laws and regulations to control the audit and accounting practicing environment, it

is obvious that restricted regulations failed to protect the neither local financial markets, nor the global economy. Rigid accounting and auditing standards encouraged entities' management to invent creative fraudulent tools and techniques without proper estimation of these techniques negative results. Such of these techniques mainly contributed to the 2008's financial crisis. Therefore neither regulations nor accounting and auditing standards could only be considered as the main variables that support audit practicing environment.

## 2.2. Audit Social Values and Ethical Trust

Typically, both audit firms and practicing regulatory organizations serve a number of varied users and societies. Audit practicing social value has been perceived academically as a tool for creating and institutionalizing social transparency. Social values are supporting organizations' management creative thinking and their communities' responsibility. It is also supporting the idea of the auditor's professional responsibilities, and the stakeholders' involvement in preparing and developing these responsibilities. **Todaro and Smith (2011, p. 321)** describe the social capital as "The productive value of a set of social institutions and norms; including group trust, expected cooperative behaviors with predictable punishments for deviations, and the shared history of successful collective action that raises expectations for participation in future cooperative behavior." **Richard (2006)** identifies audit, from both an economic and social point of view, as a social-based activity that uses a number of tools to reduce agency costs, and affects the welfare of a broad range of societal parties. Furthermore, **Nobes and Parker (2008)** identify accounting as technology that is usually practiced within varying economic, social and political contexts, while the auditor is a public watchdog that immunizes a company's financial reports from improper accounting and financial treatments. This duty requires auditor independence from his clients in order to complete his fidelity to the public. Accordingly, the auditor's responsibility is not only limited to the client who pays the fees, but also extends to investors, financial markets, and the public at large

(Volcker, 2002). Porter et al. (2005, p. 119) conclude that “audit function is rooted in the confidence that society places in the effectiveness of the audit and in the opinion of the accountant. Accordingly, if the confidence is betrayed, the function too will be destroyed, since it becomes useless.” Most of the academic researchers conclude that moral and social variables are strongly correlated to audit function. Usually social values will not working effectively without the support of non-governmental associations, or regulatory bodies that monitoring the professional community commitments and complying level. Duska (2004) argues that audit firms and practicing professions start to lose their main embedded duty, "guardians of integrity in financial dealings," as they stopped playing their fiduciary role in protecting the public interests. On the other hand, Unerman and O'Dwyer (2004) argue that recent accounting failures affect the way that non-accountants evaluate accountants, as they recognize the devastating impacts that accounting could have in society. The recent accounting and auditing failures increased the interests in the audit social responsibilities approach. Also the massive involvement of non-professional investors in financial markets, and their reliance on audited financial reports as a basic information source for their investment decisions, increased the public requests of auditors' accountability (Australian Accounting Research Foundation, 2002). The currently followed social responsibilities models are basically developed through architecture that covers all practicing social interests, policies, boards of directors, codes of conduct, corporate governance, stakeholders' engagement, environmental management, and complaints. The theme of social responsibility is gaining more international importance. Many international legal and political public policy leaders found themselves faced by challenging dynamic attempts to apply societal ethical practice standards, which connects the social responsibility theme with environmental sustainable development. This approach will integrate audit practicing social responsibility with both national and international audit-practicing regulations. It also coordinates the involvement of the government, audit firms, practicing regula-

tory organizations, and civil societies in incorporating any practicing social responsibility system, or environment reforms (**Rudnicki, 2000**). **Van de Ven (1985)** encourages the application of management functions to support the profession's social responsibilities through using the group model structure, such as practicing regulatory organizations. The group model structure is much more relative to social interests, as it is characterized based on direct feedback and high professional discretion. The group model exercises a high degree of autonomy, which is supporting both auditors and audit firms' interdependency and frequent smooth communications. However, the group social model is still considered the only available efficient structure that support accounting and audit practicing, this model exercise did not work properly in past as it was not able to prevent recent accounting and auditing scandals.

Due to their unique characteristics, and their important role in society, both audit firms and practicing regulatory organizations require a high degree of trust and ethical standards that can be affected by professional auditors' traits, qualifications, and organizations' management performance. Most accounting academic studies focused on accounting norms or the norm-processes, which directed many professional international institutions' researches to the areas of financial reporting credibility, practicing organizations trust, and the national and international financial practicing changes. Most academic researchers have consensus on the necessity to support practicing creditability and auditor's independency. **Armstrong (2002)** argues that objectivity and integrity are more important than auditor independency, as they are hard to be enforced and take time to be described in the professions' state of mind. However, many other researches warned that the auditor's impaired independency increased the audit risks, led to serious conflict of interests, and dramatically affected the financial reporting quality (**Flegm, 2005**). However, **Beaulieu and Reinstein (2006)** argue that providing non-audit services by auditors may impair their independency, and that prohibiting audit

firms from providing non-audit services will limit their financial and qualified human resources, which will decrease the audit quality and increase the audit fees. In general, independency should be considered as an independent variable that by default associated to both professional integrity and objectivity. **Domingo (2005)** concludes that it is necessary to have a new audit business ethics approach that is based on deontological and procedural methodology. This encouraged **Benston and Wagenhofe (2006)** to argue that there are two approaches for audit-practicing ethics: the first is the rules-based approach that should be co-joined with the surrounding practicing environment, while the second approach is the principle-based approach that is related to practicing ethics to the historical customary principles. The U.S.-GAAP uses the Rule-Based Approach, while IFRS uses the Principles-Based Approach (**Jamal & Tan, 2010**). However, there are a number of business literatures that largely assumed trust as a good ethical form, and many researchers argue that the subject of ethics was not properly covered as a practicing subject in both accounting and auditing curriculums, which was considered one of the main reasons that contributed to auditing scandals (**Frecka & Nichols, 2004; Gaa & Thorne, 2004**). Currently, the concept of ethical trust is gaining stronger popularity and appreciation in the management literature. Trust is usually described as the essential basis for innovation (**Hosmer, 1994**). Unfortunately, trust or trust-like behavior can be seen at the root of corrupt activities (**Husted, 1994**). These types of behaviors may allow parties in a trust-based exchange to take advantage of the other party by permitting illegal conduct with little chance of detection. Extension of the trust-creation process can affect business relationships, as ethical limitations of trust could deteriorate the professional practicing business. **Baier (1986, p. 235)** defines trust as "reliance on others' competence and willingness to look after, rather than harm." **Barber (1983)** argued that trust includes technically competent performance, responsibility, and expectations of fiduciary and moral obligations, Trust demonstrates the special concerns for others' interests above one's own interests, therefore, he classifies fiduciary

obligation into two components: benevolence and integrity. Benevolence is the extent to which a trustee is believed to want to do good to the trustor, aside from an egocentric profit motive, while the integrity element refers to the trustor's perception of the trustee adhering to a set of principles that the trustor finds acceptable. The practicing ethical dilemma is directly associated with the trust concept. It represents the quandary that a person has to face and decide between two actions while he knows that this decision will benefit one party and harm the others (**Jones, 2007**). The auditor usually faces this situation and has to overcome it through considering his role in protecting the public interests. Typically, trust should be enforced and supported by proper laws and regulations that clearly define its meaning in order to avoid individually misinterpretation and abuses. **Klaus (2008)** debates that the core soft skills and traits that should be a part of professional auditors are being self-aware, trustworthiness, conscientiousness, adaptability, critical thinking, attitude, initiative, empathy, confidence, integrity, self-control, organizational awareness, likeability, risk taking, problem solving, leadership, and time management. Simply, the professional trust concept is based on the legalization of accounting practicing ethics, which is playing an important role in increasing audit environment efficiency, and controlling the auditors' conflict of interests' dilemma. **Moore et al. (2006)** point out that solving professions' conflict of interests require significant changes in the current governing regulations, Which proves the importance of practicing law participation in developing audit practicing professions

### **2.3. Auditors and Audit Firms Professions**

The causes beyond the audit environment deficiencies may be related to the standards and laws that do not clearly identify the auditors' roles and responsibilities. These laws and standards contribute to deteriorating the communications along the audit environment. The complexity of the current financial environment requires more effective procedures from the professional auditors to verify the required compliance with international standards, local standards, and business regulations. Most



of the recent researches focused on enhancing the audit-practicing environment, financial statements quality, and audit services creditability through continuous development of the International Financial Reporting Standards (IFRS), and the International Auditing Standards (IAS). Such focus will increase the financial statements reliability and retrieve investors' trust in both organizations' financials and non-financial information. Also, it will indirectly contribute to stability and growth of the economic performance (**Cullinan, 2004**). Academic literatures point out the difference between countries' legal systems and the role that regulatory bodies may play to unify the accounting rules and reports. Many of these literatures suggest that as long as legal contract enforcement is weak, the country common law will neither influence nor guarantee the quality of accounting information (**Ball et al., 2000**). **Caprio (2009)** argues that new accounting and financial innovations should be considered by financial regulators in order to provide modern dynamic financial regulations that provide additional accountability and enhance the financials quality. On the other hand, many researchers believe that non-quality financial elements could be related to earnings management and financial restatements timeliness (**Barth et al., 2008**). These elements are associated with the most recent financial crisis and highlight the importance of auditors' independence, integrity, and the importance of using auditing standards to support auditors' independency and willingness to identify deficiencies during audit processing. There was a literary strait direction for developing a clear definition of auditors' duties to defeat the current concerns about the value of audits, and practicing regulatory organizations (**Chandler & Edwards, 1996**). Accordingly, researchers raised many new regime theories, which are basically structured on providing financial statements' users with early warning signals. These new innovative theories were mainly targeted at enhancing the financial reporting process, improving transparency, and promoting reporting integrity. Also, it will enhance the accuracy of auditor disclosures, mitigate financial misstatements risks, and limit any future financial failures (**Cunningham, 2004**). Despite that, Ar-

**nold (2009)** points out those accounting academics were far from the actual accounting practicing techniques used on the practicing environments, and the procedures followed by practicing regulators. Academic literatures focus individually on each practicing environment variable without having a proper framework that interprets this environment. Therefore, they failed to invent effective tools to prevent and deal with the repetitive financial scandals, which encouraged standard setters and non-governmental regulatory bodies to emphasize that the auditor's specialized industry's knowledge can positively enhance financial quality and reduce fraudulent reporting. On the other hand, **Gramling and Stone (2001)** conclude that there is a negative relationship between the auditor's specialized knowledge and fraudulent or restatement. Moreover, **Romanus et al. (2008)** conclude that there is a direct relation between financial statement quality and auditors' industry specialization. Typically, audit industry specialization and audit firms quality control procedures are clearly presented in big audit firms' practicing environment, which supporting the success of these firms practicing monopolization. A number of academic researchers have addressed that there are no differences between big audit firms and non big audit firms' fees estimation, and clients' retention processes; however, there are obvious differences in quality and capacity (**Gul, 1999; Hogan & Jeter, 1999**). Other academic researchers, such as **Geiger and Raghunandan (2002)**, conclude that big audit firms have more conservative reporting decisions that are always sensitive to the companies' probability of having going concerns issues. **Cooper and Robson (2006)** argue that audit firms, mainly the big firms, represent the most vital factor in the success of audit professions standardization and regulation, as these firms determine the professions' identity and affect any required future development. **Boyd (2004)** points out that decreasing the number of big giant audit firms from eight to four, as a result of consecutive mergers between these firms, led to a dramatic increase in their operational, economic, and political influential powers, which is varied from one country to another. However, most of the recent financial scandals associated with one of the big audit firms, it is still debatable that developing audit

firms quality control procedures will significantly enhance the profession practicing environment.

#### **2.4. Legal Local Enforcement versus International Standards**

Each nation states its convenient units of practicing analysis and controls based on the local laws and regulating system, which is promulgated by legislatures and standard-setting bodies. Regulators also consider the other influencing forces, such as tax system and professional accounting bodies. The accounting contemporary between countries is not an outcome of different countries' invention; it is an outcome of accumulating innovations across centuries (**Garry and Napier, 2002**). **Deegan and Unerman (2009)** also argue that there are many forces influencing the regulators while dealings with any particular financial accounting demands, such as their perceptions of public interests, economic effects, associated costs, and benefits of these accounting regulations. **Nobes and Parker (2008)** argue that accounting basic methodology has been recently affected by changes of economic developments, financial markets globalization, international monetary systems, and the growth of international organization powers. These changes require an immediate development of accounting and auditing global methodology that linked between different practicing environmental factors. **Choi and Meek (2005)** proposed a superior classification of accounting, to support developing changes, that was based on the connected economic, political, and cultural frameworks. They categorized the accounting system into four characterized sorts: accounting within a macroeconomic framework, Accounting within a microeconomic framework, accounting within an independent discipline framework, and the uniform accounting framework. Each of these classified sorts has its own unique type that makes it different from one country to another. Using any of these sorts is subject to the extent of the political and legal regulators interfering in the accounting and professions' practice structure. **Nobes and Parker (2008)** conclude that each country has its own accounting practice, audit competencies, professions' size and strength. These

unique characteristics depend on many factors, such as the countries' culture, legal systems, finance providers' structure, taxation system, and other external influences. Other academic researches point out that examining of cross countries' institutional arrangements and their effects on auditing can help in establishing natural experiments that support the study of the audit-practicing environment. **Perera (1989)** debates that any particular country accounting practices and regulations aim to suit the society requirements and circumstances at a specific time. **Baker et al. (2005)** conclude that the accounting profession environment in different countries is based on a mix of “associationism,” “corporatism,” “Liberalism,” and “legalism,” which is mainly associated with the three principles of social orders: Market, State and Community. Accordingly, both governmental and non-governmental regulatory bodies must have an important role in developing audit practicing environment.

### **2.5. Professional Practicing Environmental Culture**

Audit firms and practicing regulatory organizations' domains describe the range of organizational services that are provided to both clients and stakeholders, which requires an efficient understanding of the professions' symbolic roles and practices' tools that coordinate work processes. Academic researchers presented a number of theories that identified the relationship between practicing members' coordination, controls, structures, and the environmental constructs. Researchers theorized the functions and elements that support the symbolic role of practicing organizations, such as standard operating procedures, practicing rules, actions blueprints, code of conducts, impersonal prescriptions, ethics, rationalizing techniques, formalization, and documentation. Also, researches presented culture instrumental practicing tools that support controls and improve audit-practicing performance. Academics describe culture as “collective consciousness,” “collective programming,” or “underlying shared assumptions” that identify a group of values (**Sackman, 1991**). Unified culture requires a consensus on a number of norms and values that have to

be clearly understandable and approved by the audit-practicing community. This approach helps practicing oversight bodies to measure and compare professional members' performance. It also provides an understanding of behaviors during different audit assignments and situations (**Jaskyte & Dressler, 2004**). **Cameron and Quinn (2006)** conclude that culture changing is a long-term difficult process that requires an alignment and reinforcement of proper values that fit with the surrounding environment. This change will not succeed without the full commitment of all associated and involved parties. **Hofstede (1980)** concludes that culture drives the institutional practice through a group of societal values that requires audit firms to follow an open social system that interacts with their surrounding local and international environment, which supports the importance of an environmental screening concept in audit practicing. **Violet (1983)** argues that culture represents an interaction between human and non-human resources that affect the functioning of legal, tax, and business systems, therefore, we cannot segregate accounting and audit practicing from their surrounding culture. **Gray (1988, p. 13)** points out that accounting practicing subculture is associated with the society's general culture. Gray suggests four cultural values. "Professionalism, that gives more control power to professional associations, versus Statutory Control, that gives more control power to the governmental regulatory bodies; Uniformity, that based on rigid detailed practicing regulations to manage practicing, versus Flexibility, that based on the participating community self-regulating roles; Conservatism, that based on pessimistic measurements and reporting roles, versus Optimism, that based on opened disclosing system with limited privacy protection general rules; and Secrecy, that based on limited disclosed information, versus Transparency, that based on opened disclosing system without general protection rules." These values were based on the well-known Hofstede culture classifications of basic values: "Individualism versus Collectivism; Large versus Small Power Distance; Strong versus Weak Uncertainty Avoidance; and Masculinity versus Femininity." **Deegan and Unerman (2009, p. 109)** discussed the impact of culture on shaping accounting practices, and they conclude that

"any claims that particular frameworks of accounting are superior to others should only be made after considering the environments in which the frameworks are to be utilized." **Garry and Napier (2002)** use the concept of culture and environmental factors to study accounting practicing. Based on their exploratory case study, they conclude seven environmental factors or emerged dimensions that tended to provide a comparison structure. These factors were based on "Practices, Propagation, and Profession." However, the scale of importance of each environmental factor has not been individually measured. Some of these factors may have stronger effect on practicing environmental reform than others.

## **2.6. Professional Practicing Environmental Characteristics**

**Brandon and Mueller (2006)** conclude there are a limited number of academic researches that discussed the practicing environment changes and their effects on the auditor's responsibility and operating process. **Boyd and Rasheed (1993)** discuss the effect of the three main environmental theories: population ecology theory, contingency theory, and resource dependence theory on audit practice. The academic researchers gave more attention to the contingency environment theory, which mainly focuses on searching the environment and identifying the main factors that can be used to fit organizations into the reality (**Thompson, 1967**). Contingency theorists conclude that an organization has to put in more effort to fit in with its associated environmental forces, while institutional theorists debate that the societal values and beliefs will construct the organization's shape. Both theories confirm the importance of the organization's relationship with the surrounding environment. **Lawrence and Lorsch (1967)** argue that organizational success requires maintaining consistent differentiation and integration with the control environment demands. An organization's success depends on the management-developed steps to overcome negative environmental obstacles. **Scott (2003)** concludes that from a practicing point of view, the organizational environment has two major dimensions: the task

environment and the institutional environment. **Gupta et al. (1994)** use both contingency and institutional theories to examine how professional practicing in an institutionalized environment is coordinated and controlled. Their study proposed that the more institutionalized the environment, the more the practicing organization relies on a bureaucratic mode of control. Also, they conclude that the greater the task difficulty and team interdependence, the more the practicing organization relies on personal and group modes of control to improve the audit-team performance. Typically, the size of both audit firms and practicing regulatory organizations is a contextual variable that depends on the interface of the surrounding environment. **Keats and Hitt (1988)** conclude that organization size is strongly influenced by the complexity of the environment, as the organization's growth size should be supported by more munificent and less environment complexity. Accordingly, large-size practicing organizations are a signal of complex environmental relationships and a bureaucratic control mode. It is essential to consider the level of variability, difficulty, and interdependence of practicing regulations that affect both coordination and control of professional groups' modes (**Scott, 1995**). Organizational behavior researches classified the professional form as an isolated, separate, and distinct organizational design that consists of a unique set of differentiated specific motives. Those motives usually extended across a variety of organizational contexts, and only rely on professional systems (**Miner, et al., 1994**). Furthermore, structural contingency theorists argued that organizational behavior is subject to the structure design and operating strategy that are mainly affected by environmental contingencies. Researchers also argued about the significant correlation between organizations' strategy, structure, performance, and the environmental uncertainty perceptions (**Miller, 1987**). **Abbott (1988)** studies the significance and nature of practicing organizations' structure changes. He concludes that, as a consequence of global changes, professional practicing organizations will face a significant shift in their organizational design and class of power. However, he argues that organizations will not be

seriously threatened by recent economic and organizational managements' practicing changes. **Meyer and Rowan (1977)** conclude that practicing organizations may use relatively formalized controls for symbolic purposes, while actually exercising controls over their members via more idiosyncratic and social means. Accordingly, any practicing reform procedures should be based on proper description and understanding of the practicing environmental surrounding variables, as well as, measuring of each variable related general environment weight. This role may be varied from practicing environment to the other based on the prevailing culture.

Researchers attempted to integrate an organization environment's perceptual and objective perspectives into a single framework. **Thompson (1967)** describes the environment through using two dimensions: The first was heterogeneity/homogeneity that focuses on the similarity/differences of environmental variables comparing to each other. The second dimension was the stability/dynamism environment, which is mainly focused on the environmental variables, either predictable or unpredictable. **Child (1972)** uses similar dimensions in his research through labeling complexity and variability that reflect the degree of sophisticated knowledge necessary to operate in a given environment. Child also adds a third environmental dimension that describes the availability of required resources. On the other hand, according to **Aldrich (1979)**, environmental dimensions typology shifted the organizational environment field away from perceptual measures. The typology is based on the existence of environment objectives, and the predictions of environmental impact on the organization. **Mintzberg (1979)** introduces an additional new environmental term called market diversity, which mainly describes the organizational required knowledge and sophistication level. He concludes that market diversity is a dependent aspect of complexity that represents the breadth and depth of required knowledge. Market diversity approach is typically fitted to the audit practicing profession. It requires a high degree of professional specialization subject to the com-



plexity of applied environment. **Keats and Hitt (1988)** prove the significant relationship between the environmental dimensions and organizational strategy, structure, and performance. **Davies and Walters (2004)** study the environment effects on the private organization's strategy. They conclude that environmental effects on organization strategy are moderated. **Sillince (2005)** proposes the rhetorical congruence theory. The theory was based on organizational internal balance that fits both the organization's strategy and structure to the environmental contingencies. The theory also enables an organization to adapt its position with the surrounding environment. The rhetorical congruence theory confirms that under conditions of uncertainty, any adaptation of structural differentiation is unlikely to succeed. The theory is considered as a convenient approach that could be applied by audit firms. **Andrews et al. (2006)** study the organizational external environment constraints and their relationship with organizational performance and strategy. They point out that using the prospecting strategic planning approach is more convenient for an unpredictable environment, as it helps organizations screen new opportunities and immediately respond to any new environmental circumstances. This approach may fit to both practicing governmental and non-governmental organization, as it enables them to interact with practicing environment continuous changes that follow any financial crisis.

**Nicholas and Neil (1995)** conclude that creating accounting numbers is the main function of accounting practices. Governmental regulations and laws usually focus on controlling the accounting numbers, and formulating the nature of market information flows within a quasi-regulated environment. The process of controlling practicing and information flows is usually a mix of informal and formal sets of contracts between self-interested parties. This flows process is based on the fact that auditors are both being influenced by and influencing the environment to which they report. **Fernandez & Rainey (2006)** try to study the relationship between an organization's external environment, internal environment, and its related

performance changes. On the other hand, **Jones (2007)** identifies the specific environment as the forces outside the stakeholders group that influence the organizations' operations, such as unions and governmental bodies, while the general environment is the force that shapes the specific environment, such as economic, technological, political, and social forces.

**Tan and Tan (2005)** argue that most previous studies have focused on one aspect of the environment uncertainty or rate of change; however, there are two other critical aspects of firms' operating environment, such as complexity and munificence that have received relatively little attention. The environment complexity is subject to the interconnections between the specific and general forces, while the degree of environment complexity increased based on the numbers, strength, and association of specific and general forces. These forces also increase the environment degree of uncertainty. On the other hand, the environment dynamism represents the changing speed of both specific and general environment forces; the higher the change speed, the greater the environmental dynamism degree. Such of these environmental description should be considered thoroughly during studying of audit practicing environment general framework. According to the organizational theory, any increase in the organization's dynamism should be associated with diversification and reduction of structural divisionalization. **Pfeffer and Salancik (1978)** argue that organizations' survival and effectiveness depends on the types and size of environmental resources allocated to them, while **Tushman and Nadler (1978)** argue that effectiveness of organizational performance is a function of fitting both organizations' information-processing capacity and information-processing demand with each other's environmental variables. **Daft and Weick (1984)** suggest that an organization is an interpretive learning system that uses three interlocking stages: scanning data, interpretation collected data, and taking action based on the environmental understanding that has been enacted.

**Gray (1988)** identifies a new environmental conceptual framework for organizations, which was derived from the New Economics Foundation (NEF) concept that has been used by the Institute of Social and Ethical Accountability (ISEA). This framework mainly produced a wave of social audits, and directed organizations toward evolution through more responsible behavior. The framework used the basic dimensions of culture, which were identified within vast multinational organizations, to explain various countries and international practicing behavior differences. **Gray et al. (1997)** constructs a systematic identification of all stakeholders' groups using a refined stakeholder map that included all potential organizational accountabilities, as presented in Figure 1. He argues that the social audit framework will provide society with qualified innovative workforces. Such a workforce can act with integrity to achieve the best of public interests, and help in exceeding the negative effects of auditors' non-independence, non-innovation, and unprofessional behavior.

**Figure 1: Stakeholders' Groups**



**Source: Garry et al., 1997, pp. 2-14**

The previously discussed literatures enforced academics and regulators to reveal great concerns about the nature of auditors' responsibilities and the level of

public concerns that accounting professions need to deal with. IFAC announced its concerns of the widespread mistrust and doubts regarding the credibility of financial reporting, specifically in developed capital markets (IFAC, 2003). Accordingly, both the FASB and IASB claimed the necessity of using globally unified financial quality measures, however, until now, there are no specific identifications of these unified elements, as they are subject to the preferences of financial users (Daske & Gebhardt, 2006). Duska et al. (2011) point out that globalization forced the accounting community worldwide to consider developing one set of standards — the International Financial Reporting Standards. These standards can help in identifying a global general set of financial quality measures that should be integrated in practicing environment framework, otherwise the framework will not work effectively in different local environments. Also, Nobes and Parker (2008, p. 77) point out that harmonizing accounting and audit practicing require countries to accept both technical and political compromises. They identify accounting practicing harmonization "as a process of increasing the compatibility of accounting practices by setting bounds to their degree of variation." They classify harmonization into two types: rules harmonization (de jure) and practices harmonization (de facto). Tay and Parker (1990) conclude that both harmonization types should not be associated, and the practices of harmonization will be more efficient but harder than rules harmonization. Both law and ethics are not constant principles that should not be changed over time. Accordingly, the unitary stable environment can work properly within the professions' business through enforcing an effective global code of ethical conducts (Jones, 2007).

In summary, the growing number of recent financial scandals increased academics demands of applying strong creditable audit model that associated with professional auditors' traits and effective audit environment. This environment has to be based on international standards that designed to support capital market tools, and provide proper measuring of financial reporting quality. Despite implementing of

international standards and rigid laws, such as SOX, financial scandals and crisis continued. This situation indicates that there are additional variables, besides international standards, that structuring the audit practicing environment. Following is a summary of these practicing environment significant variables based on the previously discussed literatures:

Environmental variable	Description
Legal regime and associated support of reporting quality standards	Legal regime is a vital factor that supports audit creditability. However, legal affects may be varied across different local cultures, many literatures agree that weak law enforcement will negatively affect accounting and auditing reporting quality.
Regulatory bodies influence over maintaining of social and ethical values	Regulatory influential power is significantly influencing audit profession. It can support the profession independent social and ethical trust. Also, it may help in positively developing auditors traits
Auditors and audit firms specialization	Both auditors and audit firms have a significant contribution in weakening the surrounding audit practicing environment. In order to overcome the structured environmental deficiencies we need to set up additional accountability tools, define auditors' duties, qualifications, techniques, as well as, standardized procedures.
International and local practicing standards	Each country has its own unique practicing characteristics that based on many environmental factors, such as dominated culture, legal system, regulatory body, capital market structure, and other external influences. Both of local

	regulating systems, and international practicing standards enforce the profession local control matrix.
Practicing organizations and profession's culture	Culture represents an interaction between human and non-human resources. Therefore, practicing organizations, such as audit firms, professional associations, and governmental regulatory bodies must have a collective unified culture that fit with surrounding local, as well as, international society culture.
Practicing environment characteristics	<p>In general, both contingency and Institutional theories are considered the most convenient environmental theories that suitable for audit profession.</p> <p>Professional practicing organizations have unique and distinct design, therefore researchers classified audit practicing environment as complex structure that requires more individual and grouping control vehicles. Accordingly, integrating audit practicing environment perceptual into a signal framework will enhance its efficiency and effectiveness. In order to structure this single framework there should be a clear identification of audit practicing environmental variables, as well as, specific diagnose of its operating conditions. Such of this approach will help in outlining a unitary stable practicing environment that can be globally uniformed.</p>

The next chapters will reflect on the reviewed literatures' main ideas in the proposed audit-practicing environmental model.

## **Chapter 3**

# **Audit Practicing and Financial Market Failures**

### **Chapter 3: Audit Practicing and Financial Market Failures**

Capitalism is designed to support the efficient allocation of economic resources through the application of markets' tools. To achieve this target, credible information is vital for decision makers, which can be achieved by auditing financial statements. However, the securities pricing model should be based on international rather than domestic factors, though financial statements assurance can still help in solving one of the most sophisticated problems that is currently facing international financial markets, which is the cross-border securities' pricing (**Nobes & Parker, 2008**). Finance providers, such as banks and investors, are the basic sector components of the capitalism economies. They are considered the main forces that indirectly affect accounting practice. The degree of interrelationship between these two sectors depends on the financial system's operational structure, whether they be capital market systems, credit-based governmental systems, or credit-based financial institution systems. Each one of these financial systems requires a different size of accounting disclosures and financial details (**Parker & Nobes, 1994**). These requirements are indirectly affect audit practicing environmental structure and compliance degree. Usually financial markets rely on financial statements information and other available resources to establish the securities market price and evaluate different types of investments. Accordingly, financial statements should be accurate, reliable, and free of any misstatements that may lead to future restatements. In most cases, financial restatements give indications that significant financial information was kept away from the investors, which may significantly affect both the organizations' and their auditors' reputation.

However, not all business failures are related to auditors' misconducts; rather, most of the business failures are interpreted as auditors' mistakes. Auditors' failures always result in business crises, which indicates the importance of the audit-practicing role to the financial business. Also, it shows the necessity of implementing strong investors' protection laws to stop any kind of standards misuse, and protect the public interests (**Almer & Brody, 2002**).



### 3.1 Financial Crisis and Scandals

Capitalism regulations are based on competitive free-market mechanisms rather than relying on the governments (**Windsor & Warming, 2009**). The free market system encourages organizations to focus on competition, efficiency, and creativity rather than equality, fairness, and justice, which led to many financial wrongdoings. On the other hand, the international audit-practicing business typically represents a traditional oligopoly market that is controlled by a limited number of audit firms. Also, the financial risk assessment and valuation business is manipulated by three main international rating agencies.

Due to market concentration and aggressive competition, auditors were pressured to accept their clients' creative accounting techniques that maximize their short-term gains. However, this is unethical accounting behavior; it has been accredited by the rating agencies. During the last decade, companies raised many complex financial innovations. These innovative investment tools changed the shape of the financial sector, and prove the necessity of implementing new financial rules and regulations to protect the society's interests (**Caprio, 2009**).

The inefficient financial environment structure that is based on weak laws, accounting standards, and codes of ethics encouraged market players to mask their economic performance and manipulate the facts as they wish, which led the world to the recent financial failures and economic crisis.

#### 3.1.1 Enron Scandal

The Enron scandal resulted in global panic in the accounting and auditing field. The practicing business was mainly concerned that Enron's financial failure occurred in the largest economy that has a well-developed set of Generally Accepted Accounting Principles, and federal agencies that closely monitored the financial sector's performance, such as the Securities and Exchange Commission (SEC).

The dramatic failure and panic of Enron scandals associated with its complexity presented a joint failure of regulators, management, analysts, creditors, bankers, and public auditors, which obviously encouraged both Arthur Andersen, the auditors, and Enron's management to act in an unethical way (**Cunningham & Harris, 2006**). Enron scandal presents a good example of efficient audit practicing environment. Scandal subsequent reform steps were based only on reforming law and regulations without considering the practicing environmental multiple variables and their associated framework. These defective reforms procedures gave a negative example of non-understanding of practicing environment different theories, such as contingency and congruence theories.

### ***3.1.1.1 Enron Anecdotes and the Falling Trip***

Prior to its collapse, Enron was considered one of the strongest organizations in the financial market. Since 1997, Enron continued to have a steady quarterly growth that led its shares to outperform the U.S. stock exchange indexes. The company's management has always been described as innovative and aggressive. Enron also changed its business environment by getting involved in new technological industries that required non-traditional finance structure tools, and pushed the classical accounting and auditing standards to their limits (**Catanach & Catanach, 2003**). From the economic theory point of view, Enron created agency conflicts. The company involved the employees in its invested SPEs management. Furthermore, from a financial point of view, Enron's failure was a result of following two conflicted operational and financial strategies. The first was investing in energy and telecommunications technology that require a high debt ratio and long-term growth, while the second was dealing in swaps that requires creditworthiness and is based on quick growth.

**McLean and Elkind (2003, p. 132)** point out that the “Enron scandal grew out of a steady accumulation of habits and values and actions that began years before, and finally spiraled out of control.” The aggressive corporate culture that is based

on ambition non-controlled risks and short-term earnings managing was the main reason behind Enron's collapse. This negative culture encouraged Enron's executives to aggressively enter into new markets without business scanning, or building the industry knowledge, which ended up using improper accounting techniques, such as SPEs, to manage the company's financial problems (**Fox, 2003**). **Catanach and Catanach (2003)** point out that Enron's executives succeeded to manage its earnings during the last 10 years of the company's life. The earnings manipulation was focused on investments' structure that supports the non-consolidation of SPEs. This related parties' false and non-cash transactions with the company's SPEs represent the creative accounting tools that were used by the company to report unreal profits (**Mulford & Comiskey, 2002**). Also, the Enron business model was structured on investing in the complicated energy derivatives that require a highly judgmental accounting and discretionary market valuation, which encouraged the Financial Accounting Standards Board (FASB) to debate Enron's accounting policies due to the possibility of earnings management. In general, Enron's management deliberately kept away the financial facts from its stockholders through limiting the financial statement disclosures, which make the financial statements non-understandable even for accounting experts.

Enron's quick fall had dramatic implications over the financial and accounting practicing business, mainly the big four accounting firms, and negatively affected the overall audit-practicing reputation (**Moncarz et al., 2006**).

### ***3.1.1.2 Audit Professions and Enron Failure***

Blame for the audit scandals should not be placed only on audit professions' shoulders, as there are many other environmental forces that subscribed in placing the audit professions on the quagmire. Big-size audit firms, such as PriceWaterhouse Coopers, Ernst & Young, Arthur Andersen, Deloitte & Touche, and KPMG, used to be known as the audit-quality gatekeepers. Due to the latest financial failures, and collapses of Arthur Andersen, doubts start to rise regarding the quality of services

provided by these firms, which encouraged researchers to study the potential development affects on the audit theory and methodologies. **Ball (2009)** supports this fact, as he points out that Andersen's audits' insufficiency was not associated with specific unprofessional engagement partners, but resulted from the general inefficient management methodology that was applied within the firm.

During the last decade, there has been a strong tendency for audit professions to offer multiple services to their clients. Many of these provided services were outside the traditional scope of audit and tax preparation. These cross-selling services resulted in fatal compromise of ethical standards and led auditors into conflicts of interest. On the other hand, the continuous pressure over the organizations' management to meet the shareholders and market earnings expectations led them to present an unfair picture of their organizations' financial positions. These pressures had been transferred to the auditors and affect their integrity and their duty to protect public interests, which magnified the auditors' ethical dilemma problem (**American Assembly Report, 2003**). Audit practicing ethical concerns have been raised a long time before the Enron crisis. **Holm and Laursen (2007)** debate that Enron was the first scandal to lock up professional audit mistrust in financial reporting. In contrast, **Rajan and Zingales (2003)** argue that the audit-practicing scandal started a few weeks before the Arthur Andersen collapse in 2001, when Deloitte & Touche issued a clean positive peer review report, as part of profession's self-regulation program on Arthur Andersen. This fact increased criticism of the practicing profession when Andersen-Enron collapsed. Also, **Conroy & Emerson (2006)** point out that due to Enron's failure, society became more worried about negative consequences of accountants' and auditors' unethical behaviors, such as fraud and insider trading. Consequently, these unethical behaviors no longer become acceptable, which support the demands of increasing practicing firms' quality procedures, as well as, the monitoring tools of both governmental and non-governmental bodies.

The mix between professions' self-regulated ethics rules and the applied regulatory system cast doubt on the audit profession's legitimacy (**Windsor & Warming, 2009**). **Catanach and Catanach (2003)** conclude that Enron's collapse problem was not only in the reporting of manipulated numbers, but rather it was in the lack of auditors', analysts', regulators', and investors' monitoring procedures that did not work efficiently to highlight misreporting. This conclusion supports the necessity of setting up an audit practicing environmental framework.

Subsequent to the Enron failure, there were major changes in professions' attitudes and regulations. The Sarbanes-Oxley Act of 2002 legislated major changes to rules governing the practicing professions (**Shafer et al., 2004**). Also, the audit-practicing methodology had been changed by The Public Company Accounting Oversight Board (PCAOB), and new regulations were enforced, making auditors audit clients' internal control procedures to evaluate independency and compliance rules (**Chang et al., 2009**). As a response to audit failures, The Education Committee of the National Association of State Boards of Accountancy (NASBA) increased its professional ethics educational requirements. It focused more on the students and licensed professions' ethical trainings to improve the effectiveness of professional responsibilities. NASBA developed many educational materials that focus on useful case studies and address related practical issues (**Shawvere & Barre, 2006**). On the other hand, most of the big audit firms started to tighten their audit procedures. They dropped more than 500 risky clients to avoid any potential professional liabilities risks, and to comply with the regulators' practicing requirements.

On the international level, most of the developed countries around the world started to focus on the professions' regulatory reforms. Many countries focused on strengthening their current used corporate governance systems. However, most of these reforms, whether in North America or other countries, did not propose any reforms for the fundamental structure of the professional practicing environment, cultural, and behavior forces. Accordingly, these limited reforms processes did not

effectively help in avoiding the 2008 financial crises that mainly occurred due to inefficient regulations and unethical behaviors. Therefore, updating of practicing law may have a limited effect on reforming of professional practicing environment.

### **3.1.1.3 Sarbanes-Oxley Act (SOX)**

As a response to the Enron accounting scandal, policy makers raised their concerns about audit firms' capacity to provide fair financials reporting (**Gunther & Moore, 2002**). Both the U.S. government and audit practicing regulators started to structure additional legislation to regulate the oversight of the accounting practice. The regulating act (SOX) was based on strong corporate governance and transparency rules. Subsequently, this regulating act had been indirectly implemented by many other worldwide countries.

Law and regulation tightening always has supporters and opponents. This debate became clear during the period of SOX implementation. SOX act supporters saw that the new law would improve monitoring and support culture changes, which would positively affect both audit professions and capital markets (**Mitchell, 2003**), while opponents saw that the act would increase non-essential bureaucratic rules that may negatively affect the investment environment (**Butler & Ribstein, 2006**).

Academic researches considered SOX as a wakeup call for non-public and non-profit organizations (**Riotto, 2008**). The SOX act was based on improving the publicly traded organizations' financial transparency in order to eliminate any valuation uncertainty (**Johnston & Madura, 2009**). **Jain et al. (2008)** argue that SOX enhanced corporate governance, recovered audit creditability, increased financial quality, and improved overall transparency. One of the SOX act's dramatic changes that affected audit practicing and created a strong academic debate was the direct relationship between non-audit services and the auditor's client economic bond. The SOX act prohibited auditors from providing any non-audit services to the same audited clients that exceed 5% of the audit total fees. SOX act prohibition of non-audit services was based on the fact that these types of services always generate high fees

that can be considered as financial incentives to the auditors and may impair the auditors' independency (**Romano, 2005**).

After the SOX act was released, the Company Accounting Oversight Board (PCAOB) emphasized the necessity of detecting fraud during the audit process. This change has been interpreted in the PCAOB published Auditing Standard No. 2 and the revised Auditing Standard No. 5 that focused on auditing of companies' internal controls (**Thibodeau & Freier, 2009**).

The SOX act resulted in a paradigm shift in audit practicing. The act transformed the audit from a self-regulated business, supervised by a government agency, to a directly controlled business that was regulated by a quasi-non-governmental agency (**DeFond & Francis, 2005**). The SOX act also resulted in important changes in audit business fees, quality, and the auditors' competitive landscape. Despite all of the practicing operating changes and financial controls associated with the SOX act, it was neither effective nor efficient to protect financial markets from the subsequent 2008 financial crisis (**Aggarwal & Williamson, 2006**). Typically, SOX act provisions did not focus on the auditors' intellectual ability or on professional competencies that considered to be one of the audit practicing environmental main factors.

### **3.1.2 Earnings Management and Creative Accounting Concepts**

Earnings management is part of the creative accounting techniques that started in the 1980s. This technique is based on providing flexibility in accounting systems, which was one of the reasons behind recent accounting scandals.

Creative accounting represents a deviation from the accounting standards substance and spirit. It leads to misrepresentation of an organization's income, assets, and liabilities. It is considered a concept of practicing earnings management through improper interpreting of judgmental accounting standards, such as GAAP or IFRS. Creative accounting is associated with practicing techniques that are supported by professionals' experiences and skills. **Gherai and Balaciu (2011)** point out that the

creative accounting practice is mainly based on information limitations in addition to the moral hazards and adverse selection phenomena.

Theoretically, there is a strong positive correlation between economic decline and practicing creative accounting. During a declining economy, companies always try to enhance their earnings and hide negative results from their shareholders and the public (**Gul et al., 2002**). Alternatively, there are positive correlations between earnings management, shareholders' weak legal protections, and the high concentration of company ownership (**Leuz et al., 2003**).

### ***3.1.2.1 The Concept of Earnings Management***

Academic researches proposed that earnings management is an invasive phenomenon that is directly associated with creative accounting. The concept of earnings management is divided into legitimate and illegitimate management actions that proposed to change the entity's earnings. Earnings management is different from earnings misstatement; the latter is more serious and usually leads to restatements of the manipulated financials, and in most cases, it ends up in a company's bankruptcy (**Palmrose & Scholz, 2004**).

There are four types of earnings management that generally affect the quality of financials reporting (**Ball, 2009**):

1. Legal practice that is ethical and does not contradict accounting principles.
2. Legal practice that is unethical and does not contradict accounting principles.
3. Negligent or gross negligent practices.
4. Fraudulent practices.

Typically, earnings management is not one of the accounting technical concepts that had a common known definition. It represents a management strategy to adjust a company's reported income through taking additional accounting decisions. Virtually most management decisions may affect the organization's earnings, which can be classified as earnings management actions. **Schipper (1989, p. 92)** defines



earnings management as “A purposeful intervention in the external financial reporting process, with the intention of obtaining some private gain.” **Nelson et al. (2003)** found that derivatives, discretionary accruals, and transactions structuring are the most popular techniques of earnings management. Earnings management can be formed in real cash flow economic actions that may be related to operating or investing activities (**Roychowdhury, 2006**). After the Sarbanes-Oxley Act, the companies' trials to meet analysts' earnings expectations have been dramatically reduced. Accordingly, accrual earnings management techniques have been decreased, while the real earnings management techniques have increased to compensate the decreases in accruals (**Cohen et al., 2008**). Also, the numbers of new sophisticated financial vehicles have been increased after releasing of SOX act, which led to 2008's financial crisis. Therefore we may conclude that tightening of laws and regulations are not an efficient tools to either protect investors, or to reform audit practicing environment.

**Fields et al. (2001)** conclude that earnings management can be associated with the capital market through any of the market principles, such as the agency costs or information asymmetries. The agency cost principle is mainly represented in the Moral Hazard phenomenon, which is based on the agents' advantages through their authority and power to pursue their self-interests over the principle or public interests. However, this principle may increase the probability of unethical behavior and fraud (**Jones, 2007**). To overcome the adverse selection and moral hazard phenomena, organizations started to apply bonus plan methods, which is one of the reasons behind the spreading of earnings management practicing through the negative affect of information asymmetry that represents the intention for transactions to affect the companies' share prices. From the audit-practicing point of view, **Myers et al. (2003)** argue that earnings management is positively correlated to lengthening the auditor-client relationship, as well as potential pressure.

### 3.1.2.2 *Reasons Behind Spreading of Creative Accounting*

Organizations' management should have a degree of flexibility when practicing and managing their financial and accounting results. This flexibility degree should be based on realism without committing earnings management. **Dharan (2002)** points out that the recent increase of using earnings management, as a creative accounting tool, has become more serious and negatively affects the auditing and accounting business. It threatens the financials reporting quality, and compromises accounting information fundamentals, such as relevance, objectivity, and reliability. **Gherai and Balaciu (2011)** argue that as long as human creativity has unknown boundaries, the use of creative accounting will not disappear from the accounting practice unless the reasons behind using it disappeared. Accordingly, avoiding creative accounting practices techniques must begin with controlling the causes behind these negative behaviors, and studying the circumstances that lead to these types of actions. Therefore, increasing of auditor and management ethical and morality values may help in mitigating such of these negative behaviors.

Market pressures on companies' management to meet analysts' expectations, issuing equity, or beating industry benchmarks are the main reasons for practicing creative accounting (**Jensen et al., 2004**). Companies are willing to sacrifice their economic long-term value in order to achieve short-term earnings. Also, rigid accounting standards always force companies to use creative accounting techniques. However, these techniques may potentially lead to high costs and reduce the companies' market values (**Ewert & Wagenhofer, 2004**). **Dechow and Skinner (2000)** argue that earnings management and creative accounting techniques are strongly associated with the bull market management stock option, compensation scheme, and the companies proposed incentives to their key persons. Typically organizations always target to achieve rewards from creative accounting, such as controlling share prices, managing borrowing costs, enhancing credit rating, or increasing incentive compensation plans for key employees.

Earnings management does not enhance the organization's underlying economic activities, as it only based on manipulating practicing accounting standards. **Davidson (2011)** and **Graham et al. (2005)** point out that accounting fraud and earnings management increase as percentage of developed countries' GDP; particularly, when the economy reaches its peak point, and the organization's share price is sensitive to revenue news.

Managers always have a lower incentive to commit fraud or earnings management during periods that have a high actual and expected performance since the organization's overall performance will also be high (**Povel et al., 2007**). However, the Lax of regulating environment will encourage organizations' managers to misreport financials results; mostly if they find out there are other similar companies that started misreporting (**Kedia et al., 2010**). Usually, companies increase their investments during financial misreported periods to gain more growth prospects. The probability of this scenario increases when the company is a part of a group of companies, and when ownership is more disperse (**Kim & Yi, 2006**).

### ***3.1.2.3 The Auditors' Role in Creative Accounting and Fraud***

Typically, financial reporting quality is measured by the degree of earnings management, financial restatements and the associated timeliness (**Barth et al., 2008**). Due to the sophistication of the current global economy, financial audit becomes more of an art than a science. Current audit practicing requires a high degree of judgment by well-experienced professions to detect and signal any sign of malfeasance or fraud (**American Assembly Report, 2003**). Most of the academic researchers agreed that creative accounting is based on the professional accounting interpretation and speculation of regulations and standards requirements. The auditors' ethical dilemma that is associated with creative accounting was raised because of the audit professions' aggressiveness versus conservative interpretation of accounting and auditing standards.

Earnings management represents the main unethical behavior that faces audit practice. The auditor perception and reaction against earnings management transactions varies based on the precision of applied accounting standards (**Leung & Cooper, 2005**). **Armstrong (2002)** concludes that decisions about earnings management include ethically unsustainable differences between auditors. Other academic researches focus on studying three main types of financial window-dressings: earnings manipulation, earnings management, and earnings restatements (**Agrawal & Cooper, 2009**). **Mulford and Comiskey (2002, p. 59)** argue that earnings management is a toll of creative accounting. They define earnings management as "the active manipulation of accounting results for the purpose of creating an altered impression of business performance."

Many accounting academic researchers find an inverse relation between auditor's independency and both earnings management and earnings restatements. Typically, companies prefer to continue with the same auditors if they have financial difficulties. Accounting earnings management techniques are predestined by most academics, while operating earnings management techniques are not. Academic literatures point out that the main reason beyond financial restatements is the use of earnings management techniques in order to overstate assets and revenues (**Palmrose et al., 2001**). Accordingly, most academic researchers agreed that auditors always focus more on preventing earnings management that lead to an increase in income. Auditors do not consider those factors that may lead to income decreasing, assuming that liabilities and legal responsibilities will be more questionable in the first case more than in the second (**Bonner et al., 1998**). Usually, the auditors' litigation risk always increases when the company reports abnormal accruals or fraudulent transactions (**Heninger, 2001**).

**Gherai and Balaciu (2011)** conclude that the main difference between fraud and creative accounting is the intention for illegal acts that lead to damage. Fraudulent accounting is bending the accounting standards, while creative accounting is

breaking them, as creative accounting is using financial engineering to present a specific accounting image. **National Association of Certified Fraud Examiners (1993, p. 12)** defines fraud as "the intentional, deliberate misstatement or omission of material facts, or accounting data, which is misleading and, when considered with all the information made available, would cause the reader to change or alter his or her judgment or decision." Thus, the key element in fraud is the intention of deceit. **Montgomery et al. (2002)** introduce the concept of "Fraud Triangle" that is structured on three main conditions to measure the probability of any current or future fraud. The triangle consists of Incentive/Pressure, Opportunity, and Attitude/ Rationalizations. The triangle reflects three important forces that are based on the audit risk theory: management integrity, auditors' independency, and proper control procedures. **Vona (2008)** points out that practicing audit procedures are not effective enough to identify different types of creative accounting and fraudulent actions, therefore, auditors should improve their knowledge of fraud science and creative accounting techniques to support their skills in assessing the risk of any potential fraud. Generally, most of used aggressively creative accounting vehicles may be classified as fraudulent activities if they measured based on fraud triangle. Therefore, auditors' skepticism and morality are important functions for audit practicing environment reform.

Auditors usually design their practicing procedures in a way that supports the discovery of any significant earnings management and fraud (**Vona, 2008**). **Caneghem (2004)** points out a positive correlation between auditor's specialization and discovering of earnings management and fraudulent transactions. This fact has been confirmed by **Beaulieu and Reinstein (2006)** who point out that due to differences in competences and specialization skills, the trend among big-sized audit firms is to report less discretionary accruals than small-sized ones. It is easy for auditors to detect and investigate errors; however, it will be difficult, but not impossible, for auditors to detect creative accounting due to the management intention to hide the real facts. Also, **Coffee and Berlet (2001)** conclude that independent auditors do not fulfill their main role as gatekeepers that comply with law and support corporate

governances. They also added that the responsibility of earnings management is shared between auditors and corporate management, and earnings management has been recently increased because of the inherent limitations of the auditor's role and capacity. Conversely, **Burns and Kedia (2006)** conclude that both top management and external auditors are involved in the processing of financial reporting creative accounting, which indicates the difficulty of any proposed efforts to mitigate this kind of non-ethical behavior.

### **3.1.3 The Financial Crisis**

The U.S. economy is the leader of international markets. Subsequent to the 2000 NASDAQ Stock Market dotcom bubble, and the 2001 terror attacks, the U.S. government tried very hard to beat the economic recession. Unfortunately, this negative economic environment, followed by the property price inflation that is associated with credit growth, resulted in the subprime crisis. This rickety period was also based on insufficient regulations, inappropriate financial rules, and overpayments to companies' top managements that were breaching the basics of proper corporate governance. Consequently, the United States investment banking industry was wiped out by the 2008 financial crisis (**Bicksler, 2008**). Typically, the 2008 financial crisis presented the model of financial systemic failure, which encouraged the academic researchers to claim the necessity of financial market regulation. **Taleb (2007)** concludes that the overconfidence of the financial system, ignoring the market systematic risks by both bankers and regulators, and the complexity of financial markets led to the failure of both credit rating agencies and auditors' warning system. Also, they increased the magnitude of the recent financial crisis.

#### ***3.1.3.1 Reasons beyond the 2008 Global Financial Crisis Start up***

Financial crisis vulnerabilities had built up for several years before 2008, based mainly on weak practicing control procedures, policies, strategies, and non-ethical behavior from banks' management and regulators. The crisis showed how the federal banking systems and oversight regulatory agencies failed to provide safe and sound

lending and financial reporting practices that mitigate the securities risks and avoid the organizational unethical behaviors.

Prior to the start of the subprime mortgage crisis in 2007, the mortgage securities vehicles were simple financial instruments mostly held by banks and recorded in their balance sheets. Also, financial derivatives were rarely used by the investments and finance sectors. On the other hand, banking's weak borrowings internal controls processing procedures increased the roles of mortgage brokers in approving the granting of facilities. Banks did not properly consider the mortgage brokers' obvious conflict of interests associated with their paid commissions (**Caprio, 2009**). The increase of mortgage values in banks, which were affected by the inflation of property prices, encouraged financial investment companies to introduce a high-risk complex combined securitization financial instrument, such as CDOs "Collateralized Debt Obligations." Due to the high financial risks associated with these securities, investment companies started to use Credit Rating Agencies to accredit these new investment vehicles. The credit agencies' accreditation enabled investment companies to insure their issued CDOs from big insurance companies and sell them in the international financial markets. These instruments were basically — based on auditors approval — accounted as off-balance sheets investments through Structured Investment Vehicles (SIVs). As such, this inaccurate accounting treatment negatively affected the quality of investment-sector-disclosed financial information (**Barth et al., 2009**). Once interest rates increased during 2007, property prices started to decrease, and home owners stopped paying their installments. As a result, banks found themselves required to write down a huge amount of nonqualified loans, which led to more restrictions on the banks' capability to finance new loans. The limited banks' finance capabilities decelerated the economic fundamentals and business cycles increased the number of unemployed and expanded national burdens (**Sikka, 2009**).

Usually any new financial derivative products should have proper standards for risk management and pricing to penetrate the market. The regulatory loopholes and the complexity of the CDO's securitization, combined with the use of off-balance sheet investment vehicles, resulted in improper derivative pricing valuation, and evaded the basic regulatory requirements. These improper financial treatments led to a significant deterioration of the financial sector. Also, it extended the risk to other stakeholders who rely on the financial statements as their base source for risk analysis (**Ferguson, 2008**). **Taylor (2009)** debates that the two main reasons beyond the 2008 financial crisis were the ineffective interest rate policies followed by the U.S. Federal Reserve, and the weakness of governmental agencies' monetary procedures that failed to highlight the risks of the new complex adjustable-rate sub-prime securitization. On the other hand, **Caprio (2009, p. 10)** argues that the Securitization and Collateralized Debt Obligations' (CDOs) investments were the main reason beyond the 2008 subprime crisis. He defines the CDOs as "a financial investment innovation that allowed people to make a bet in which their downside loss was limited and much of which could be passed back to the banks and/or holders of securities." The regulatory authorities' implemented systems failed to effectively detect the financial risks of improper activities of both the regulated and unregulated shadow banking sector.

Theoretically, the 2008 financial crisis was based on two main factors: the complexity of the international financial environment, and the complexity of internationally used technical financial tools that are associated with improper financial governance roles. The crisis had unique characteristics, as it had a global dimension due to the increased connectivity of the international financial systems. This unification supports the international debates about the necessity of using dynamic regulations for financial markets to avoid any future crisis. The success of these proposed dynamic regulations is associated with the practicing laws, accountability rules, quality controls monitoring procedures, and effective regulatory bodies may directly affect the audit practicing environment.



### 3.1.3.2 Credit Rating Agencies' Role in the 2008 Global Financial Crisis

Credit Rating Agencies are key and powerful players in the free market. Their main stream of income is generated from the clients that they are supposed to monitor and evaluate, which raised many concerns about their independency, and the expected conflict of interests between their public fiduciary duties and their loyalty to the audited clients. Typically, credit rating agencies (CRAs) do not perform an independent review of their clients' financial information (**Rousseau, 2006**). Usually CRAs do more financial analysis during initial rating stages, while doing less during the periodic surveillances of the already assigned rates. The CRA investment analysts do not use their professional skepticism; they always accept unrealistic assumptions, such as the companies' capability to generate steady quarterly earnings increase. **Hill (2004)** concludes that one of the main reasons behind the CRAs' failures was the lack of competition between the rating agencies. There is a limited number of credit rating agencies working in this field. The big three CRAs manipulated 94% of the international rating markets and only compete based on the quantity and size instead of the quality (**European Commission, 2008**).

The 2008 financial crisis uncovered the weakness of CRAs' corporate governance systems, which held the main CRAs, such as Moody's, Standard and Poor's, and Fitch, responsible for the financial market failures. These firms did alert neither the professional nor the community of the expected credit bubble risks. Typically, CRAs should act as the investors' valuable safeguards that protect investors from any specific investments' inherent risks. Conversely, CRAs strongly contributed to the financial crisis through covering of the CDOs and related securities real risks. The CRAs' main problems are coming from their conflicted interests' business model, which is based on the "issuer pays" concept. Also, they are using outdated rating models and unqualified staff, which negatively affects their provided services quality. **Langohr and Langohr (2008)** conclude that CRAs' recommended valuations were inadequately considering neither risk analysis nor conflicts of interests that may rise from the lack of competition. The CRAs' ratings decisions directly

increased the magnitude of the financial crisis by labeling intoxicated securities as safe investments, and helped in creating an even bigger monster through continuing to award top ratings to both mortgage-backed securities (MBSs) and Collateralized Debt Obligations (CDOs) (**Brunnermeier, 2009**).

However, the U.S. SEC had the full authority to regulate CRAs, based on the Credit Rating Agency Reform Act of 2005, but SEC failed to effectively regulate the new innovative free market (**Soros, 2008**). By 2008 the United States' Securities and Exchange Commission (SEC) concluded that CRAs have many deficiencies that assisted in the subprime financial crisis (**SEC, 2008**). Due to the nature of CRAs' opinions that were considered as predicative, not fact opinions, dissimilar to the case of the auditor's opinion, the legal liability of CRAs was always considered to be minimum. Therefore, none of the regulatory oversight bodies were able to hold CRAs liable for any negligence or misrepresentations (**McDaniel, 2008**). During 2009, new regulations had been issued for CRAs by many international and local regulators, which forced them to avoid any kind of conflict of interests through prohibiting providing advice to their clients about packaging securities for rating purpose, as well as ratings companies that they provide capital structure consultancy (**Marshall, 2009**).

Despite the 2009 regulating laws, CRAs still need more rigid regulations, such as those used for audit practicing. Also, CRAs' credibility and competency should be independently evaluated, and aggressively face any discovered unethical behaviors. These reforms can be more effective if CRAs comply with the International Organization of Securities Commissions' Code of Conducts (**IOSCO, 2008**). The current CRAs' operating environment requires many reform steps through increasing the appropriate level of external oversight; developing of the ratings process quality; enhancing monitoring procedures for issued ratings update; applying more safeguards to reduce any conflicts of interest; and providing more disclosures about the adequacy of organization resources. Also, CRAs' regulating system needs to be

restructured through accurate peer review of rankings steps, increase of civil law accountability, and decrease of the federal government's reliance on privately issued credit ratings. All of these required reforming steps must be in consistent with practicing profession standards, Accordingly, CRAs' governing regulations must be equal to the audit practicing ones.

### **3.1.3.3 Auditors' Role in the 2008 Global Financial Crisis**

The negative reputation associated with the audit professions, due to the repeated financial scandals and the recent global financial crisis, had badly reduced the public's trust in the practicing value, and increased damages to the capital market integrity. The 2008 financial crisis raised the necessity of properly expanding auditors' duties and responsibilities to achieve financial market stability (**Krishnan, 2011**).

In practice, both investors and regulators use the companies' financial statements to base their financial decisions, economic estimates, and risk exposure analysis (**Stiglitz, 2003**). Typically, the big four international audit firms are supposed to provide high-quality unified services. These firms have set up proper internal processes and regulations that are followed by their entire network. Also, they have highly qualified technical and human resources that support their operations. The big firms' internal processes include quality control procedures that represent a self-regulation internal standard. Unfortunately, most of the recent financial scandals arose after a few months of companies being audited by one of the big audit firms. **Chung and Kallapur (2003)** conclude that though clients of big audit firms always report less accruals and management earnings, the magnitude and size of damages resulted from big audit firms' failures are always devastating.

The dimension of the 2008 financial crisis, its extent, and complexity encouraged researchers to investigate the real reasons beyond the audit profession's failure to stop this crisis. Most of the related academic researchers present many concerns

regarding auditors' independency, objectivity, and ethical values. Many other researchers conclude that the auditors do not properly recognize the importance of financial accounting disclosures. **Magnan (2009)** argues that the financial crisis raised the auditor's failure to assess the investments underlying cash flow risks, while **Mahoney (2009)** concludes that the detailed codified financial accounting standards may hinder the auditors' professional skepticism and led to the financial crisis. Also, most of the collapsed companies complied with the letter of standards rules, but not with their principle substance. The researches' evidences support the fact that auditors neither performed their due care nor required skepticism while reporting, or properly applied the substance of accounting and auditing standards (**Rona-Tas & Hiss, 2010**). **Duska (2005)** concludes that both auditors and audit firms did not perform their core ethical roles in protecting public interests, as they mainly focused on the profitability of audit business and became "accumulators of wealth for their own sake." **Frankel et al. (2002)** point out there is a positive correlation between the non-audit high fees, and both the high abnormal accruals and earnings management that may lead to the auditor's failures. Furthermore, **Duska et al. (2011)** conclude that ethics is an essential value that smoothly supports the continuity of any business. They debate that the audit profession's commercialization negatively affected audit practicing and corrupted its ethical values, which resulted in most of the audit failures and financial crisis. Typically, considering accounting and auditing professions as a business will make it fall under the profit maximization model, and put the auditors under the clients' pressures, which override the profession's independency.

**Bogle (2000)** identifies five risks that pressurized audit firms' practicing performance and ethical values. These risks represent the main reasons for the recent financial crisis. Also, they work as warning systems that limit any future audit failures. The five pressurizing risks are summarized as follows:

1. Outdated accounting and auditing standards that do not cope with modern economic changes.
2. Increasing unethical concepts, such as earnings management and accounting creative financial engineering.
3. Unclear new methods of accounting management's incentives, and compensations.
4. The aggressive unethical uses of tax shelter schemes.
5. Audit profession's weak independencies' measurements and increase of auditors' conflict of interests due to new practicing alternative business structures and advisories.

In general, audit-practicing professions had a very negative role in controlling and prohibiting the recent global financial crisis, which increased the crisis damages' size and the consequences that followed. Also, the 2008's financial crisis presents the importance of auditor's social role in protecting public interests, which represents the main object that underneath audit practicing environment.

## 3.2 Audit Quality and Practicing Environment

Many accounting-related theories focus on structuring environmental systematic coherence between accounting as a social concept and its practice. The main theories are represented in Decision Usefulness Theories, Public Interest Theory, Capture Theory, Legitimacy Theory, Stakeholder Theory, and Positive Accounting Theory. The importance of these theories increased during the last decade due to the high numbers of accounting failures. Accordingly, accountants are encouraged to understand the theories beyond the applied practice in order to be able to positively argue their followed accounting methodologies, as well as to enhance them (**Deegan & Unerman, 2009**).

Transparent and accurate financial information is the most important subject for financial analysis. Increasing the reliability of financial data requires effective accounting standards and strong regulations that eliminate any types of accounting judgments (**Nobes & Parker, 2008**). Financial non-transparency always limited the investors' capability to properly assess the investment's financial risks. Therefore, accounting standard setters and market regulators tried to find a common ground to improve the financial reporting needs in a dynamic way to prevent any future financial crisis.

### 3.2.1 Auditors and Quality of Financials Reporting

Accounting information quality affects organizations' cost of capital either directly, through the organization's cash flows and investors' assessment of financial risks, or indirectly through enhancing the organizational operation decisions (**Ashbaugh-Skaife et al., 2009**).

#### 3.2.1.1 *Financial Reporting and Audit Quality*

An audit service is currently classified as a commodity that is subject to the economic demand theory. Audit firms are currently pushed to follow market competition and client satisfaction approaches. Accordingly, they start to reduce their cost without considering the deterioration effects on both staff and audit quality.

This dramatic paradigm in the audit profession's model impaired the auditor's independency and integrity (**American Assembly Report, 2003**). As a consequence of changes in the practicing professions, the IFAC requested all audit firms to adhere to the audit quality control system. The quality system provides assurance that audit firms are following proper regulations and professional standards, such as appropriate identification of Leadership responsibilities, efficient client's acceptance/continuity processes, effective Code of Ethics, and human resources procedures.

Financial statements quality is subject to the auditors' competencies and capabilities to report discovered financial misstatements. **Riyatno (2007)** argues that audit and financial reporting quality's definition is an abstract that is perceived by audited clients and financial statement users, and for that reason it is difficult to measure. **Caprio (2009)** points out that creating off-balance sheet tools, such as securitizations, will negatively affect the financials reporting quality. Also, it will limit the ability of organizations' management and financial statements' users to evaluate risk exposures.

The recent accounting scandals' researches confirmed that one of the main criticisms for earnings management is the non-transparency that led to obscuring the organization's true earnings. This situation increased the scrutiny over the auditors' assurance role and the companies' earnings quality (**Browning & Weil, 2002**). In practice, there is a positive relation between disclosures' quality, cash flow prediction accuracy, and auditors' industry-specialization (**Gramling & Stone, 2001**). Recently, FASB started to oblige companies to disclose both qualitative and quantitative information about their financial instrument's fair values and estimates (**FASB, 2009**). The financial reporting quality system can reduce the private sector's volatility and the probability of financial crisis. Also, it can increase investors' trust, reduce cost of capital, and encourage global market integration (**Hegarty et al., 2004**). Currently, many accounting literatures encourage disclosing the company's financial and non-financial indicators to support its share's market value (**Krishnan & Parsons,**

**2008). Ronen and Yaari (2008)** debate that auditor knowledge of the applicable legal systems, and understanding their clients internal controls procedures, are necessary for accounting scene recognition. This understanding will improve the financial reporting system and help decrease the level of discretionary accruals (**Owhoso et al., 2002**).

The auditors' main target should be to implement the best treatment and appropriate accounting principles based on the circumstances and accounting standards requirements (**Shafer et al., 2004**). Checking the quality of companies' financial statements will limit audit-associated risks, and help external auditors in providing reassurance to the organization's stakeholders, such as investors, banks, and public society. Historically, big audit firms were associated with high audit quality that was usually used by companies to send creditability signals to shareholders and investors (**Ettredge et al., 2011**). However, currently the competitions between small- and middle-size audit firms decreased audit fees and negatively affected audit quality (**Ireland & Lennox, 2000**). Conversely, **Simon (2011)** argues that audit quality is not perfectly associated with big audit firms; however, it can be significantly associated. Some of the big audit firms provide an average level of quality based on the country they practice in, and the restriction level of laws and regulations. Audit quality is subject to many other factors, such as auditor's specialization, skepticism, knowledge, training, regulators effective monitoring, and efficiency of followed standards. All of these factors represent the main components of practicing firms' quality procedures that affect audit practicing environment in different ways.

### **3.2.1.2 Auditor Role in Recent Financial Scandals**

Academic researchers used to study companies such as Sunbeam, Enron, WorldCom, Tyco, and HealthSouth for their stunning performances. Currently, these companies are studied for their failures that were associated with auditors' poor ethical attitudes. During 2005, the number of recorded restatements in the US



reached 1,195 companies. The increase of financial reports' restatements escalated public scrutiny about the auditors, and the audit procedure quality measures.

Enron's failure had the highest magnitude in audit modern history, as it demolished one of the big international audit firms, Arthur Andersen's, and resulted in many dramatic global changes in audit-practicing professions. The energy giant's failure was associated with the company's auditors' aggressive interpretation of GAAPs. Andersen agreed to issue Enron's financial statements without any audit qualifications. On December 3, 2001, Enron filed for bankruptcy and sued Andersen for misconduct. On January 10, 2002, Andersen shredded documents related to Enron's audit. During June 2002, a number of Andersen's clients started to disclose financial restatements and impropriety. On March 15, 2002, Andersen was sentenced by the court for obstruction of justice, and was banned from practicing in the field altogether (**Chaney & Philipich, 2002**). As a result of legal suits against Andersen, its clients share prices started to be negatively affected, which resulted in dramatic turmoil in international capital markets. (**Callen & Morel, 2002**).

As a consequence to Enron's and other companies' subsequent financial scandals, audit practicing came under attack. There was consensus from the regulators and the public about the importance of reforming auditors' independency, morality, and ethical values. Regulators started to develop proper compliance programs, and enhanced the transparency of financial statements in order to narrow the expectation gap between the practicing professions and public society.

Researchers debate that the auditors' negative role in the last financial scandals is mainly associated with agency theory dilemma. The fiduciary or trust structure relationship between the auditor and its clients made the clients treat auditors as agents that should act on their behalf. Audit clients always expect auditors to be morally bound to their interests, which totally contradicts the auditors' role in servicing the public and limiting its ethical duties. The negative magnitude of the agency theory had been increased by the unethical behavior of the auditors. Auditors

used to substantially base their audit firms' revenues on non-audit services and consultancy advice to their audited clients. However, auditors debated that providing consultancy to their current clients increases the clients' based knowledge and enhances the overall audit and financial quality. On the other hand, academic researches indicate that providing non-audit services critically impairs auditors' independency and makes them vulnerable to their clients' pressures. Also, it negatively affects their duty to act in a socially responsible way (**Agrawal & Chadha, 2005**). This was confirmed by the U.S. SEC when it issued concerns during 1998 and 2000 related to the increase of audit firms' non-audit services to their current audited clients. The SEC warned that this situation might increase the probability of compromising auditors' independencies (**Coffee & Berle, 2001**).

### **3.2.1.3** *Audit Firms Subsequent to the Financial Scandals*

The audit firm is an integrated part of its surrounding community. It holds social obligations to act in the best of public interests. Alternatively, the audit firm is similar to any other profit-oriented organization. Its aim is to control its cost-efficiency while providing high-quality services, which may put pressure on the audit firm from its clients (**Daugherty & Tervo, 2008**). Audit firms' quality of services may be different from one client to the other, based on the client's industry and size. The bigger the client's size, the more attention the audit firm gives (**Myers et al., 2003**). Financial failures and crisis decreased confidence in the audit practicing firms' performance and governing regulations. Also, it increased the public's requests to develop new rules that regulate these firms' practicing procedures and increase control over their activities. Many researchers conclude the necessity of implementing governance procedures over the practicing of audit firms, in addition to improving their staff training and educational systems (**Dharan, 2002**).

Additionally, the audit market's oligopoly structure limited the companies' alternatives regarding choice of auditor experts. A lack of resources available to audit firms makes them incapable of covering the market gap. Lack of competitiveness

between audit firms negatively affects the audit market's efficiency. Due to the special nature of audit services, there are no product differentiations between big audit firms. The only differentiation between most audit firms is price. Thus, the audit business market model became one of price-based competition (**Eisenberg & Macey, 2004**). Therefore, **Beaulieu and Reinstein (2006)** conclude that there is a different economic self-interest between big and small audit firms, and this creates different perceptions about independence based on the firm size.

Subsequent to Arthur Andersen's collapse, **Eisenberg and Macey (2004)** studied the operating environment in big audit firms, including Arthur Andersen. They noticed that all big firms are following a similar administration structure, practicing model, corporate governance, and auditing methodology that Arthur Andersen applied. They conclude that the practicing causes that led to the audit failures are general and spread all over the professions' business. Usually, high-risk clients switching between big audit firms will be compensated by increasing the fee, so the same client could be audited by another big audit firm (**Landsman et al., 2009**). **Choi et al. (2004)** debate those big-firm clients' portfolios risk is always change based on the litigation environment. Some of the risky clients may move out from the audit firms' portfolio, while other risky clients may join the same portfolio. Therefore, the same level of risk will remain in the market.

Typically, subsequent to any financial scandals, the audit clients' risk will be reallocated to smaller audit firms that have less resources, quality control, and experience (**Ettredge et al., 2011**). As a result, small audit firms may build a position of high-risk clients without paying attention to the audit quality and public interests, which in the future may lead to new financial scandals. Therefore, enhancing of practicing firms' quality control procedures, whether these firms are big or small will increase the efficiency of audit practicing environment.

### 3.2.2 Audit Practicing and Ethical Environment

Auditors usually face the same dilemma of loyalty dividing and different perceptions of their responsibilities. Auditors have to serve owners, stakeholders, and satisfy company managers at the same time. This dilemma is creating a case of conflicted multi-tasking with different interests, which is considered one of the reasons that led to the recent, and future, financial scandals and crisis. The influence and powerful ethical rules will be different from one society to the other. However, there are basic general ethical values that should be implemented in any society, such as trustworthiness, honesty, competence, and temperance. Without a proper ethical role the practicing professions will shift to a virtue state of nature that does not follow any kind of ethical values or morality. Structuring to practice ethical values will efficiently shift audit practicing to a level of perfection, and will support the process of transforming the practicing society's general context into a spiritual ethical society. Also, it will positively enhance the general way of practicing.

For centuries, researchers debated the definition of ethics. The research studies presented three models of ethics identifications: the Utilitarian model, the Moral Right model, and the Justice model. These models were based on the main three sources of ethical values: societal ethics, professional ethics, and individual ethics. Ethical values are an emerging part that is associated with any culture (**Jones, 2007**). Audit practicing should have effective indicators and tools to evaluate the professional ethics environment and monitor any risks. In order to establish this ethical culture, the audit practicing profession must focus on creating a proper practicing code of conduct, provide continuous ethics training programs, support ethical behavior of its members, establish the bases that support professional audit firms' social responsibility, and set up a proper mechanism for continuous ethics review of its members.

### 3.2.2.1 *Ethics Environment and Morality Fundamentals*

The importance of ethics significantly increased during the last decade. The business ethics represents the base for any civilized society, and the social capital provides the general meaning of morals and values that support any future development of the practicing environment. Therefore, audit professional bodies are responsible for setting up the normative and descriptive professional ethical disciplines. This role has dramatically increased as a response to the growth of audit business failures and financial scandals, which pushed governments, regulators, and the public to react adversely to any ethical standards violators.

Ethics need to be seen as an integral part of the professions' practicing. Thus, audit practice regulators started to encourage audit firms to reform their ethical standards, and set up procedures to ensure that their staff have proper ethical training that supports compliance programs, and identify any possible wrongdoing. Some practicing bodies obliged audit firms to conduct a regular ethical audit by specialists in order to ensure that ethical values are unified and consistent with firms' management policies and social expectations (**Carmichael et al., 2008**). Ethical standards will be more efficient if they are regulated by law, and became obligatory for all listed companies, practicing professions, and related governmental agencies.

The recent accounting scandals raised the inappropriateness of ethics' rule-based approach and confirmed the necessity of relying on a principles-based approach (**Macnamara & Banff, 2004**). However, **Agoglia (2011)** concludes the necessity of using the two approaches in administering ethical behavior. **American Management Association (2006)** identifies five main drivers that impact ethical implementation, brand protection, and reputation. These drivers mainly focus on maintaining clients' trust, investors' confidence, and public acceptance recognition. These drivers represent the base for audit-practicing ethics.

On the other hand, **Kahneman and Tversky (2000)** debate that management perception is always affected by distortions and biases, which shows the importance

of using morality. Morality is not a private affair; it is a mutually beneficial social contract that limits on the pursuit of self-interests between people. Morality has two main types: objective morality, which presents what is actually right, and subjective morality, which presents the person's beliefs on what is right. Utilitarianism is an interpretation of human motivation for self-interest maximization, which is based on the standard economic assumptions and acts against the morality concepts. **Satava et al. (2006)** point out the importance of basing the morality normative on the auditors' ethical behavior to increase the professions' trustworthiness.

### **3.2.2.2** *Conflict of Interests and Auditor Independency*

**Lenz (2008)** concludes that recent financial scandals should be classified as ethical failures. However, auditor compliance with codes of conduct will not force the ethics effectiveness, as the auditor has to maintain a rational self-interest, in addition to his objectivity, integrity, and independency. **Moore et al. (2006)** argue that conflicts of interest were the basic force beyond most of the financial scandals. It is either resulted from the auditor's turn to play the client's role, auditors providing non-audit services, or managers hiring and firing auditors. All of these cases will impair the auditor's independency. For that reason, **Gaynor (2002)** recommends disclosing the detailed relationship with the audited clients, and audit fees will increase auditors' independency safeguards, and enhance practicing firms' quality controls.

The auditor's independence is the cornerstone for audit practicing that safeguards any conflict of interests. **Nobes and Parker (2008)** argue that the more the organization's ownership is separated from management, the more the owners will be interested in an independent financial statement with detailed disclosures. Typically, auditors join the audit work with an expectation to issue a clean report in order to avoid any conflict with the client's desires, which may lead to replace the auditors. Therefore, auditors always plan for a smooth relationship with their clients to be able to sell them more services, which is impairing auditors' independency. **Powers et al.**

(2002) study the conflict between the external audit function and acceptable independency. They argue that audit firms are capitalist organizations that rely on their clients' management for income, which impairs the basics of their independency. **Moore et al. (2010)** debate that maintaining the auditors hiring and firing authority with the audited clients' management will lead to biases in favor of the audited companies. Also, it will increase the risk of close relationships between the auditors and their clients, which affects the auditors' professional judgments and transfers the auditor to a client's advocate. Therefore, enhancing auditors' independence is considered to be a main part of several legislations, such as the Statement on Auditing Standards (SAS) and the Sarbanes-Oxley Act (SOX). The target of these legislations is to bring back public trust in the audit profession.

### **3.2.2.3** *Code of Ethics*

A high credit environment always supports stable practicing ethical behavior. A code of ethics is the perfect tool to build the general public's confidence in practicing ethics, however, it does not guarantee neither the public support nor the profession's compliance. On the other hand, ethical responsibilities usually debated between communities due to the different social context, culture, laws, and professional norms. Therefore, a code of ethics structures the lines between acceptable and unacceptable practice behavior. It is a process of transforming the moral philosophy into simple understandable regulations and rules that support any judgmental decision, and mitigates the side effects of non-common consensus about ethical values. Also, a code of ethics represents rigid shared morality values between different communities to identify good and bad behavior. It provides a general framework to support auditors' professional obligations and clarify their rights. In view of that, auditors can evaluate any threats and provide the proper safeguards. The general ethical framework also acts as a proactive tool for professions to protect auditors from any

improper actions (**Heninger, 2001**). Also, it supports the reformed role of both governmental and non-governmental regulators in developing an effective audit practicing environment.

From an economic point of view, auditors can be described as rational economic agents. Their actions should comply with the code of ethics; otherwise, they will harm themselves and others (**Lenz, 2008**). Therefore, IFAC obliged auditors to follow up its ethical pronouncements through its national members' professional bodies. Any audit that uses International Auditing Standards must be associated with using IFAC's Code of Ethics, which requires auditors to have special characteristics, such as integrity, objectivity, professional competence, due care, confidentiality, professional behavior, professional skepticism, and independency.

### **3.2.3 Corporate and Audit Practicing Governing Environment**

The world economic shift from the industrial to information age pushed organizations to operate with more dynamic and responsive techniques. These operating techniques must be capable of facing the hyper turbulent surrounding environment. **Cameron and Quinn (2006)** point out that an organization's clear authority, coding of working procedures, and quality control standards will establish comprehensible decision-making lines, as well as, support of the organization's efforts in handling complicated and high volume transactions.

#### **3.2.3.1 Practicing Environment and Expectations Gap**

The multitasking environments that are associated with high knowledge-intensity, such as the audit practice environment, are characterized with a high level of responsibility delegation (**Nicolai & Laursen, 2005**). The accounting practicing preventive environment will be more effective if it is based on authoritative compliance systems. This type of environment is always classified as a high-risk environment that negatively affects many associated parties in case of any improper accounting conduct (**Robertson & Hawkins, 1999**). Environment understanding approaches always help in conceptualizing and forming the organizational performance. Also,



it supports researchers in diagnosing the causes and symptoms that affect organizations' behaviors (**Allred & Swan, 2005**). This approach is effective in understanding and developing of audit practicing efficiency.

An organization has to recognize all important environmental changes that surround its operations; consequently, it can achieve consistent development in its operational behavior and limit any environmental threats. Typically, environment analysis requires completing three steps, "environmental scanning, interpreting environmental factors, and acting on threats and opportunities." Environmental scanning is the initiative step of change. It includes significant actions that focus on understanding and interpreting environment variables. Environment fundamental information is an essential element in developing organizations' performance (**Garg et al., 2003**). The organization's incapability to change within the surrounding environment may result from its strong internal inertia that hinders management's changing efforts (**Jones, 2007**). On the other hand, organizational routines and rigid operating standards are considered as dominant and increase an organization's inertia and hurdles any environmental changes (**Larsen & Lomi, 2002**). This kind of routine-regulated inertia is applicable for organizations that are working in the audit profession practice (**Gilbert, 2005**).

Chaotic turbulences in the external environment increase the risk of culture competency and its capability to support organizational success (**Cameron & Quinn, 2006**). Also, a high-turbulent external environment negatively affects the efficiency of public-service organizations. This type of environment requires a strong organizational response through redeveloping of organizational structure in order to match the environmental domain, which helps in turning the surrounding environment into a more stable mode.

The volatile environment always constructs strong constraints on the organizations' performance development, which was clear in the period subsequent to Enron's failure and during the 2008 financial crisis. Financial scandals always create

strong turbulences in the global financial and audit practice environment. Therefore, regulators started to search for local and international reforms to maintain financial and audit practice structure stability during times of crisis (**Gilbert, 2006**).

Organizational changes may be necessary to maintain environmental alignment and reduce environmental turbulence's negative effects. Starting organizational changes will most likely lead to further changes; however, after a period of time the changes accumulation pattern decreases (**Beck et al., 2008**). In general, environmental change will present new opportunities that an organization may efficiently use to create proper congruence between changes in magnitude, timing, and strategic direction (**Zajac et al., 2000**).

### **3.2.3.2 Corporate and Audit Professions Governance**

However, audit practicing is a private profession in which the public's responsibilities represent the core center of its function. Subsequent to Enron's financial scandal, the concept of governance started to grow between business sectors, regulators, and academics. Many developed countries have structured regulating procedures and corporate governance systems to manage sustainable financial markets and trustable audit businesses. However, the concept was not capable of blocking the damages resulting from the 2008 economic meltdown, as it helped in reducing its negative effects. Typically, the governance concept could not eliminate the magnitude of negative actions associated with morality or lack of effective regulations.

Practicing regulation has two advantages: first it sets up the practicing standards, and second it monitors the practicing compliance degree associated with the standards. These two advantages can be achieved either through direct or indirect regulations (**Perry, 1985**). Corporate governance, as a governing approach, can help in improving the accounting profession's performance and regulation through certifying the adequacy of financial reports, internal controls, and the effectiveness role of the audit committee (**Cooper & Robson, 2006**). This proper financials' certification will help in avoiding financial scandals, such as Enron and WorldCom that gave

direct examples of failed corporate governance, accounting abuses, and outright greed. **Agrawal and Chadha (2005)** conclude that probability and magnitude of financial reporting restatements will significantly decreased if companies efficiently implement corporate governance approach. This improvement helped in reducing management pressures on auditors, and increased their independency.

Corporate governance implementation is subject to the organizational structure, which may be different between organizations based on their surrounding environments (**Hermalin, 2005**). **Schermerhorn (2010)** argues that while corporate governance helps in supporting the organization's social responsibility and ethical behavior, it is still doubtful that the governance approach will work adequately. Consequently, Schermerhorn suggests a new effective ethical approach that he called "ethics self-governance in day-to-day work behavior." This approach may not be suitable for regulated professional activities, such as audit practicing. **Beretta and Bozzolan (2004)** argue that effectiveness of internal control, corporate governance systems, and risk disclosure transparencies have more effects on the quality of financial reporting. Typically, poor governance might lead to earnings management; as a result, organizations that have ineffective internal controls expected a higher probability of future restatements than those that have effective internal controls (**Ronen & Yaari, 2008**).

### ***3.2.3.3 Audit Practicing Legalization versus Non-legalization***

The legal system is one of the important factors that has significant effects on the auditing practicing environment (**DeFond & Francis, 2005**). Due to the market imperfection, governments usually release regulations to face problems that cannot be fixed by free-market governance mechanisms and controls. Regulation is law, rule, or other order prescribed by the authority to regulate conduct. Subsequent to the Enron scandal there were great demands from politicians, interest groups, and

the public to enhance accounting governing regulations, which ended up with releasing the Sarbanes Oxley Act (SOX). The rules applied by SOX have been followed worldwide, particularly by the EU countries (**Akhigbe et al., 2009**).

There are two general theories of regulation. The first theory is The Public Interest Theory that considers the client (public) to be the center and encourages governmental central regulation to respond to public demands that are related to market failure correction. The second theory is The Interest Group Theory that accords recognition to interests groups, and those who support these groups, like accounting associations. Normally, it is difficult for a legislative body, such as the government, to control professional regulatory agencies due to their sophisticated specialized business. Therefore, it will be more convenient to implement a mixed-market regulating approach that is based on both theories.

Success of any regulatory system depends on the standards enforcement more than the setting of these standards. Usually, the regulators' main target of issuing new acts is focused on enhancing accountability and companies reporting transparency with consideration of the audit firms' value interests. On the other hand, increasing regulations requirements will force many audit firms to accept audit assignments with expected loss to cover the new regulations followings' costs. Also, it will encourage auditors to trigger additional profitable consulting assignments, which increase the risk of impairing the auditor's independency, and reduce the audit function creditability (**Coleman & Bryan, 2002**). Consequently, **Zhang (2007)** argues that increasing practicing professions regulations through rigid rules and laws may negatively affect the market performance in the short term; however, the positive side will be started in the long term due to decreasing of unsystematic risks, and reduction of investors uncertainty and market prices volatility.

"There is a progressive move away from complete self-regulation of auditing professions toward the independent regulation within a statutory framework" (**Hegarty et al., 2004, p. 12**). Recent academic researches recognized the importance of the dynamic regulatory system and legislative framework, which strengthen the financial system market forces (**Hetzel, 2009**). Many researchers argue that laws and

regulations changes will not help in increasing auditors' ethical behaviors. They encourage impeding ethical value in the center of the professionals' organizations through following the self-regulation concept (**Rockness & Rockness, 2005**). The self-regulation concept is considered to be the most important practicing regulation approach due to its structure on the professional practicing state of mind (**Perry, 1985**).

Tightening of both audit professions regulations and practicing quality control procedures will be more effective than professions self-regulation, or rigid rules. Alternatively, the non-governmental regulatory bodies are playing an important role through controlling and monitoring the practicing profession's self-regulation. Accordingly, the more strength the regulating bodies have, the more professional attitude the members will have. Generally, a modified self-regulation structure may be more effective for audit profession, but it will require strong partnership between public oversight boards, audit firms, and the national accounting bodies.

## **Chapter 4**

# **Audit Practicing Internal and External Environment**

## Chapter 4: Audit Practicing Internal and External Environment

At the outset, we need to define the meaning of practicing organization: It represents any of the organizations that are related to or affect the audit practicing environment, such as Audit Firms, Governmental Practicing Regulation Bodies, Non-governmental Professional Bodies, and Associations.

As a result of local and international business expansions, markets become so challenging and strongly competitive. Current markets' challenges require organizations to have strong self-differentiated services. The new shift in global markets' structure is putting new pressure forces on professions, such as accounting and auditing firms, to act differently. Practicing professions need to restructure their organizations' strategic planning, staff qualifications, required knowledge, provided services, geographical distributions, and societal roles. The current audit practice environment requires fundamental restructuring of the practicing governance forces, structure, and culture. Studying the practice of the disciplinary process must consider the overall environment, which includes both social and non-social dimensions for both internal and external practice environments. **Power and Reid (2005)** debate that environmental turbulence is more correlated to the organization's internal environment, rather than its external environment. Based on contingency theory proposals, adapting proper internal organizational structure will enhance the organizations' performance (**Pennings, 1992**). Audit practice environmental analysis should be based on individuals' perceptions of internal factors, such as environment complexity, uncertainty, or dynamism (**Miller, 1993**). Recently, organizational culture transferred to a market-oriented culture. The market forces usually form an organization's performance. Accordingly, organizations become more dragged to their external environment than internal ones (**Cameron & Quinn, 2006**).

The definition of practicing regulatory organizations, and audit firms' common characteristics, are not different from any other regular organization. Typically, an organization is defined as a social invention that formed to achieve certain goals

through the coordination of specific groups' efforts. Organization is a basic part of community structure that cannot be isolated from the broader society. Its survival is subject to equilibrium alignment to the surrounding external environment. Therefore, successful organizations should implement a proper internal structure that patterns the relationship between tasks, differentiated roles, available resources, social processes, operational interactions, and physical propinquity.

The organizational theory focuses on social structure and its effects on organizations' management behavior, culture, group habits, strategies, and business plans. Generally, the social structure specifies the individual position and his interactions in the surrounding social space. **Hutzschenreuter and Kleindienst (2006, p. 710)** point out six perspectives of the environment landscape: "rational mechanistic, cognitive, upper echelon, middle management, organic, and micro." Environmental perspectives can be either categorized to external groups, such as customers, suppliers, competitions, and regulatory groups, or external forces, such as complexity, dynamism, and munificence. Also, environmental perspectives can be classified based on attributes, such as dynamism, complexity, and hostility (**Bourgeois, 1980**). **Greenwood and Lachman (1996)** considered practicing organizations as non-bureaucratic social-organizations that usually have flexible management functions to be able to deal with their complex environment. In general, audit practicing organizations' surrounding environment has a major impact on management operations, employee performance, and service effectiveness. Consequently, the audit practice environment should include regulators, other authorities, regulatory bodies, influential stakeholders, public policy makers, and educational training associations (**Hegarty et al., 2004**). On the other hand, audit practice internal environment factors can be classified into three main categories:

- Leadership Style: Mainly focuses on achieving employee satisfaction and link their performance to the firm's objectives;



- Management Practices: Focuses on employees participating and being involvement in decisions made through proper distribution and design of work flows, increase communications efficiency, provide employees with social support, rewards, and work-life balance; and
- Pervading culture: Encourages firm members' shared values.

*The following part of the research presents analyses of both audit firms and practicing regulatory organizations' surrounding environment main factors, and their relation with the audit-practicing profession.*

## 4.1 Audit Practicing Internal Environment

Environmental changes are the most radical challenges that threaten both audit firms and practicing regulating organizations. Consequently, they should set up proper management systems that support interaction and integration with their environmental changes. Proper management systems will increase the profession's ability to serve different clients and provide practicing organizations with a continuous capability to plan, monitor, and control the surrounding environment. Environmental control reflects the organization's economic sociology, the related influence on its management, and power-dependence relations within its networks (**Nicolai & Laursen, 2005**).

Typically, organizations working in a munificent environment will face limited competitive pressures, and have more strategic options and structural harmony. **Hillman (2005)** argues that organizations operating in heavily regulated industries, such as the audit profession business, have a more non-organic management structure than organizations operating in less-regulated industries. Also, the contingency theory identifies the importance of congruence between the environment and organizational structure. The theory encourages organizations to control their environment by implementing a proper internal structure to match the surrounding environment. This structure may be established, either organically or through a mechanistic organizational structure, by focusing on four major organizational characteristics: size, structure, strategy, and performance (**Jones, 2007**). In general, researchers do not unanimously agree on common organizational characteristics, traits, or how they should be labeled.

In the following section, we will discuss the three main organizational traits that are frequently identified and more related to both audit firms and practicing regulatory organizations: objective, structure, culture and behavior:

- Objective

Objective reflects an organization's future target. Setting organizational objectives requires proper understanding of its relationships with the external environment. If environment variables change significantly, organizational objectives should be concurrently changed, and the quicker the better.

- Structure

Structure is always affected by organizational size and implemented technology. Size and complexity are always related to the specialization of an organization. In general, the structure of both audit firms and practicing regulatory organizations should fit their objectives. It is usually hard to change structure once it is established. Hence, inflexibility limits an organization's attempt to adapt to any of its environmental changes.

- Culture and Behavior

Organizational culture influences its behavior and vice-versa. Both culture and behavior are interrelated. An employee's positive behavior is functional, productive, and valuable to the organization; otherwise his or her negative behavior is dysfunctional. Both functional and dysfunctional behaviors are parts of the organizational reality that reflects the organizational culture.

The expectancy theory realizes that people generate behavior in order to gratify their personal goals and needs, and not necessarily to meet their organizations' objectives if they are different. Therefore, the theory suggests there should be rewards and compensations to encourage people to perform tasks. Usually, an individuals' behavior is affected when they become part of a group, association, or unity, as these structures always enforce individuals to respect their standards, values, and goals.

#### **4.1.1. Audit-Practicing Organizations' Objectives**

A business' objective within environmental uncertainty is based on the complexity and variability of external surrounding factors. Both **Priem et al. (2002)** and **McMullen and Shepherd (2006)** argue that environmental uncertainty is always

raised due to doubts about potential unpredictable variations, and difficult and unforeseen competitive conditions. Society is always interested in the professions model, as it specifies values and ethical behavior expected from professions. Typically, society can change the business' operating rules, or affect its basic assumptions. The professions' social values may be dedication to clients' service, lifelong careers, up-from-the-ranks management succession, professional skills, consensus management, level consciousness, or a strong focus on regulatory matters (**Tunstall, 1985b**). **Solomon (1992)** concludes that practicing organizations and professional institutions often direct their individual members' goals through aspirations. **Zucker (1986)** proposes that social institutions and professional associations represent the trust cornerstone, as they have the proper mechanisms to structure the cheating costs and benefits. They also support the meaning of their members' trust and present it to the public as title insurance.

Enhancing the professions' organizational performance is subject to the interrelationship between the professions' objectives, strategy, structure, and the surrounding environment (**Roberts, 2004**). As global business environment has become dispersed and more complicated, it promotes interpersonal trust as a main objective of both audit firms and practicing regulatory organizations. Therefore, audit-practicing objectives, working manuals, and procedures should be derived from the values of ethical and professional codes of conduct, instead of the organizational hierarchy (**Miner, 1981**). **Miner et al. (1994)** presented their Professional Theory that supports the operations model of both audit firms and practicing regulatory organizations. The theory was mainly based on the following five audit-practicing objective desires:

- Knowledge Desire: focuses on the firms' acquisition of learning and knowledge.
- Independency Desire: focuses on responsible and professional client relationships that help provide appreciated independent services to the society, the clients, and the overall public although the client might want something else.

- Status Desire: focuses on acquiring accepted status that matches the expectations of current and potential service users.
- Help Others Desire: focuses on professional client-central relationship, and a value-based demonstration of a professions' ethical role.

**Jones and Bowie (1998)** conclude that an organization's efficiency depends on mutual trust, a group's behavioral efforts, that are usually based on both explicit and implicit professional commitments. Typically, trust is influenced by the following:

- Long service relationship;
- Shared goals and experiences;
- Mutual disclosure between parties; and
- Demonstration of a fair and equitable relationship.

Characteristic-based trust is the main objective of both audit firms and practicing regulatory organizations. It proves the organization's reputation and trustworthiness (**Landa, 1994**). In many countries, accounting and auditing firms work without any contradictions or influence from the government, due to their expertise and specialized knowledge (**Nobes & Parker, 2008**). Typically, a professional practicing environment requires both characteristic-based and process-based trust. Unfortunately, characteristic-based trust does not build on process-based trust, which depends upon a high degree of regulated practicing environment. **Ackroyd and Thompson (1999)** assume that organizations have either a low trust regime or a high trust regime. The low trust regime is the most critical and is influenced by general mistrust and suspicion between employees and requires continuous surveillance of their behavior aspects. There are four types of relationships between low trust and the related degree of regulations:

- Low trust: high regulation; this leads to recalcitrance/militancy;
- Low trust: low regulation; this leads to an indulgency pattern;
- High trust: high regulation; this leads to controlled autonomy; and
- High trust: low regulation; this leads to responsible autonomy.

Typically, a high trust and low regulation working environment is considered to be the most efficient business working environment. While, the high trust and high regulation environment is ideal for audit firms, as it is based on the high levels of measurement and traceability.

#### **4.1.2. Audit-Practicing Organizations' Structure**

The professional organizational structure could vary between decentralization and centralization, based on the country's culture. Any practicing organizational structure, including audit firms, will always struggle to achieve balance between two contradicting objectives, to increase clients' values, and to reduce production costs. The audit profession is a complex activity that is based on the practicing individuals' personality. Therefore, audit practice organizations should maintain clear structure, rules, and guidelines in order to increase its professional efficiency (**Patrick & Maister, 2001**). Both audit firms and practicing regulatory organizations usually have a unique type of structure, including managerial functions responsible for strategic planning, operations directing, processes coordination, and staff control. Also, both are always occupied by professional persons (**Miner, 1981**).

Organizational institutional theory is based on the idea that organizations always try to adapt to the surrounding institutional environment, however, this may occur without taking into account the most efficient operational characteristics (**Scott, 1995**). Institutional theorists argue that the bureaucratic control mode of operating standards is not commonly used by practicing regulatory organizations, as this type of organizational performance does not properly respond to social environmental demands. Furthermore, institutional theorists encourage the development of a formal organizational structure that can please both governmental and non-governmental practicing regulators. This structure must gain its legitimacy from conforming to the acceptable practice that agreed with the external environment and public expectations (**DiMaggio & Powell, 1983**).

**Keats (1983)** argues that an organization's performance is a market/operation-attributed multidimensional construct. Some academic researches discuss the effects of market pressures and the external environment on operating decisions, behaviors, and structure of audit-practicing organizations. They conclude that practicing organizations usually adopt non-uniform flexible internal structures to deal with environmental changes. **Miner et al. (1994)** propose that organizations, such as audit practicing firms, are professionally committed and interested in acquiring knowledge to provide independent services to their clients. Moreover, bureaucratic organizations, such as governmental monitoring bodies and private non-governmental associations, have distinctive targets and professional systems that assume their oversight key roles. Therefore, they extensively rely on committees and voting systems.

Organizations' characteristics have an influence on the environmental perception process. The organic structure gives organizations the capability of delegating, participating, creating, and adapting its operations (**Brouthers et al., 2000**). Traditional management theory argues that the shift from a mechanistic to organic structure might be beneficial in a turbulent environment (**Zuniga-Vicente & Vicente-Lorente, 2006**). **Jones (2007)** argues that employees' organizational ethics and structure are all factors that shape the organizational culture. Accordingly, an organization's behavior will be a result of its design and the balance that management keeps between internal and external environmental pressures. Usually, a volatile environment requires organizations to implement a local responsiveness strategy that relies on non-integrated operations and decentralized structure. A stable environment, on the other hand, requires a general strategy that combines integrated tight operations and centralized structure (**Brickley et al., 2003**).

**Miner et al. (1994)** suggest that a distinctive feature of a practicing organization is the concentration of authority and operating decisions in the hands of its

team. They also add that once bureaucracy supersedes the professional form of management, despite that professionals might still be part of the organization, the practicing organization construct will no longer exist. Usually the highly centralized mechanistic form of operating structure is based on lower density, lower centrality, and a larger number of clusters, which is successful for organizations that operate in a stable environment. However, the decentralized organic organizational form is a flexible structure that is more suitable for a volatile environment (**Leifer & Huber, 1977**). Essentially, auditors must follow the letter of the law. Usually they interpret the law requirements in one of two available structure types: the associationism type, which is based on establishing an organization that represents a group of professionals, and the corporatism type that mainly relies on the state principle of hierarchical control (**Nobes & Parker, 2008**).

Based on the previously discussed facts, it is recommended to use a mechanistic design for both audit firms and practicing regulatory organization. This type of design is basically structured on a highly specific and delimiting job description, highly formalized procedures, and centralization. Also, the mechanistic design is more appropriate for practicing organizations due to the special types of services they provide, and their association to the society interests' protection (**Keats & Hitt, 1988**). The following table summarizes the main characteristics of the mechanistic structure:



**Characteristics of Mechanistic Structures****Table 1**

<i>Factor</i>	<i>Mechanistic Structure Characteristics</i>
Differentiation and integration	Specialized differentiation of functional tasks and problems;
Work focus	The abstract nature of each individual task is pursued with techniques that [are] more or less distinct;
Task Definition	The reconciliation for each level in the hierarchy by the immediate superiors, who are responsible for seeing that each is relevant in his own special part of the main task;
Role Definition	The precise definition of rights, obligations, and technical methods attached to each functional role;
Responsibility	The translation of rights, obligations, and methods into the responsibilities of a functional position;
Structure	Hierarchic structure of controls, authorities, and communications;
Focus of Authority	A reinforcement of the hierarchic structure by the location of knowledge that exclusively concentrated at the top of the hierarchy;
Communication Flow	The tendency for interaction between members of the concern to be vertical;
Communication Context	A tendency for operations and working behavior to be governed by the instructions and decisions issued by superiors;
Loyalty	Insistence on loyalty to the concern and obedience to superiors as a condition of membership;
Prestige	A greater importance and prestige attaching to internal than to general knowledge, experience, and skill.

*Source: Burns & Stalker, 1961, pp. 119–125.*

### 4.1.3. Practicing Organizations' Environmental Culture

The accounting and auditing profession environment is based on a mix of “associationism,” “corporatism,” “liberalism,” and “legalism,” which is mainly associated with the three principles of social orders: market, state, and community (**Baker et al., 2005**). The deregulation of financial services represents a key competitive environmental challenge for professions. Deregulation requires shifting of a current stable culture to an adaptable culture that supports the organizational society concept. Organizations' culture focus on enhancing leaders' behavior and employees' morale, which improves an organization's performance, as well as followers' perceptions of the general culture, visions, philosophies, and business strategies (**Gordon, 1991**). **Trice and Beyer (1993)** argue that an organization is an environmental-dependent structure that is linked and intertwined with other organizations in the rest of the surrounding environment. The internal and external environments typically affect the organizational cultures. Also, both environment and culture affect the distribution of powers and controls in any organization. Organizations usually develop value systems, strategies, structures, and processes that are consistent with their surrounding environment and culture (**Gagliardi, 1986**). The concept of culture and its relationship with the surrounding environment is important for managing any organizational changes.

Over the past decade there have been a great number of literatures about the concept of organizational culture, and the concepts of changing organizational culture. Many schools proposed definitions of organizational cultures; each one of them had its own major theorists and research traditions. **Allaire and Firsirotu (1984, p. 219)** define organizational culture as “a system of knowledge and standards for perceiving, believing, evaluating, and acting.” From an ecological adaptations perspective, culture is seen as “a system of socially transmitted behavior patterns that serve to relate human communities to their ecological settings.” Another definition proposed by **Schein (2004, p. 2)** defines culture as “a pattern of shared basic assumptions learned by a group as it solved its problems of external adaptation and internal integration, that has worked well enough to be considered valid, and to be taught to

new members as the correct way to perceive, think, and feel in relation to those problems."

An organization's cultural literature widely discusses the magnitude of organizational norms on both beliefs and behavior. Culture shapes organizations' beliefs, behavioral practices, organizational interaction, and reforms implementation patterns (**Moon, 1999**). Organizational learning and entrepreneurship culture represent the final outcome of managements' initial beliefs and its employees' adoption of these beliefs. Therefore, culture needs to be ingrained in the minds of the employees at any organization. **Davis (1984)** concludes that an organization's cultural values can be developed from its members. He proposes that if the values are not shared properly between the organization and the sub organization, this will lead to a weak culture or a lack of culture altogether.

Different countries' cultures may distort accepted ethical values. Therefore, audit practicing must have the same ethical standards in any country, otherwise, financial statements will not have the same degree of credibility. Audit ethical values increase trust and overcome cultural differences. Also, they identify the environmental issues that may provoke the ethical code of conduct (**Libby & Thorne, 2004**). Recently, practicing organizations realized the importance of culture in improving their structures and objectives. Strong culture is a result of widely held values and enhanced coordination of effective controls within the surrounding environment. It increases the organization's competitive advantages; however, it may be inappropriately used by unethical owners and managers. Big audit firms, such as Arthur Anderson, used to have a very strong culture with a rigid and cult-like effect on the firms' members. This rigid culture was negatively used by both firms' managers and partners. Arthur Anderson's management forgot the real meaning of ethics by deliberately misguiding its staff during audit planning in order to obtain more consultancy assignments (**Jones, 2007**).

Different organizations in the professional environment may have different subcultures that could affect, in several ways, the profession's general culture if they do not agree on fundamentals. This situation reflects the necessity of having proper

cultural congruence procedures (**Chenhall, 2006**). Professional practicing's main culture is usually associated with non-governmental regulatory bodies that regulate the practice business, while the subculture is associated with the private audit-practicing organizations or firms. Typically, the quality of an audit firms' sub-culture mainly depends on the performance quality of the practicing regulatory body's main culture.

The most critical elements of organizational culture are stability (culture is shared and rather stable because it defines the group); depth (culture involves unconscious parts of organizational life); and breadth (culture covers all of the organization's functioning and patterning) (**Schein, 2004**). **Moore (2000)** proposes four main characteristics to identify the type of organizational culture. He concludes that all organizations will have central tendencies that allow them to be categorized into one of the four culture models, described in Table 2, that we associate with audit-practicing businesses.

**Culture Models Classification**  
**Table 2**

Culture Type	Description	Suitability to Audit-Practicing Environment
Competence	-Group contribution is less important than individual contributions; - More focus on the quantitative aspects than the qualitative ones; and - Achievements are driven through organizations.	No
Control	Associated with systems, procedures, and processes that are emphasized on the followed plans.	Yes
Collaboration	-Following of team-focused culture; -Focus on the in-depth knowledge of customers and stakeholders; and - Create strong relationships with other organizations.	Yes
Cultivation	Build on individuals' beliefs that deliver dramatic innovation.	No

**Source: Researcher**

Recently, researchers like **Cameron and Quinn (2006)** argue that there are four main culture types that should be considered while studying the dimensions of any culture: the Hierarchy Culture, the Market Culture, the Clan Culture, and the Adhocracy Culture. They conclude that at least one or two of these culture types can dominate any organization. They reveal a new way of classifying the types of cultures, as per Table 3, based on the definition of competitiveness. Any organizational culture always has a life cycle that forces it to move from one type of culture to the other as a response to the development of the organization's operations' system, change in the surrounding environment, and competitive pressures. Certain types of cultural values will become dominant when an organization faces challenges. This may help the organization become more stable and flexible to adapt itself within the rapidly changing environment.

**Culture Types Classification**  
**Table 3**

Culture Type	Description	Suitability to Audit-Practicing Environment
Clan culture	Applicable for flexible organization that focuses on internal maintenance, and sensitive for people and customers with high degree of commitment. The organization emphasizes human resources development, cohesion, and morale.	Yes
Hierarchical culture	Encourage stability, control enforcement, formal task settings, strict rules, and obedience.	Yes
Adhocracy culture	Focus on dynamic flexible external positioning, and individualism open system. The long-term objective is growth and developing new resources.	No
Marketing culture	Focus on aggressively competing, customers' satisfaction, and product effectiveness.	No

**Source: Researcher**

Often, audit-practicing ideology serves as a culture starting point for both practicing regulatory organizations and audit firm. The culture of a practicing regulatory organization represents its personality that manages values, norms, and behaviors. It can be described as a system that acts upon feedback from society, professions, and laws. This type of culture should be based on values, such as society service and public interest protection.

Both audit firms and regulatory organizations' culture is typically based on staff qualifications; accordingly, any changes in these organizations' culture require employee support for the new values. Also, both audit firms and practicing regulatory organizations do not apply any specific rules for decision-making. They attempt to make decisions that are consistent with particular kinds of excellence virtues, such as courage, wisdom, temperance, fairness, integrity, and consistency. These virtues represent the core of practicing organizations, and audit firms' ethical values.

In general, the audit-practicing environment encourages both practicing regulators and audit firms to encompass values that support any cultural development. This can be done by setting general rules, applying codes of ethics, monitoring independence, practicing qualifications, and emphasizing strategic values that support a practicing organization's statement of mission and vision. Based on **Cameron's and Quinn's (2006)** culture types classification, we can conclude that audit practice culture may be classified as a Clan/Collaboration Culture for professional audit firms, and as a Hierarchy/Control Culture for both governmental and nongovernmental regulatory bodies.

## 4.2 Audit-Practicing External Environment

The external environment has become increasingly important for both audit firms and practicing regulatory organizations. This is due to the free-market policy and easy-going nature of capital transfer between countries. The external environment is influenced by an international context that is mainly represented through international practicing institutions, such as IFRS Board and committees (The International Financial Reporting Standards), IOSCO (The International Organization of Securities Commissions), and IFAC Committees (The International Federation of Accountants). **Aldrich and Ruef (2006)** point out that globalization resulted in very rapid environmental transformations and shorter life cycles. These substantial changes have led to the reduction of information analysis time, the increase of environmental uncertainty, and transaction complexity. This trend supports the new approaches of audit professional services that are based on risk analysis. The environmental changes have also increased cooperation between international auditing and accounting organizations. International organizations' objective is to develop, implement, and regulate a comprehensive global framework that will fill any gaps and unify professional practicing codes (**Hegarty et al., 2004**). **Pooran, (2010)** concludes the importance of having an appropriate allocation of responsibilities between international organizations. This allocation will support structuring of an effective global institutional framework. This framework will assist policy makers to face the global highly volatile financial environment, and support their immediate actions to reduce any financial crisis' negative consequences (**Marshall, 2009**).

**Lynn et al. (2000)** argue that the logic beyond the governance of the organizational external environment consists of legal, economic, social, and political dimensions. This governance will affect the organization's overall performance, structure, managerial behavior, and working processes. In real practice, each organization has its own unique environment, which is linked to its different business variables and affects the daily operations and activities. This specific environment represents a key part of the organizational external environment.



Successful organizations should have a detailed business strategy, including a description of the internal organizational structure that clearly determines any available opportunities and identifies any expected threats in the surrounding environment. The organizational relationship between both the surrounding environment elements and the driving type of members will identify the environment effect on the social structure. Usually, organizations operate in complex conditions and different structures. Moreover, organizations should interact by default with many environmental, social, economic, and political forces that are managed by other surrounding organizations (**Bastedo, 2004**). The environmental forces may provide sustainable recourses that support the organization's performance. Gate Keepers' organizations, such as audit firms, use external complex social relationships to obtain more recourses through munificent environments; while audit firms that work in high competing and less munificent environments describe more illegal acts. Typically, the auditing industry represents a quite homogeneous industry from the products and resources point of view — however there may be heterogeneity with regard to the audit firms' brands, formal structure, size, and employment (**Prajogo, 2006**).

Environment can be described through identifying its four main dimensions: complexity, instability, dynamism, and resource availability. There is a strong relationship between organizational structural design, performance, and the environmental dimensional variables. The interchange level between an organization's structure and environmental dimensions determine the organization's interdependency degree with the external environment. **Duncan (1972)** presented two key environmental dimensions, static-dynamic and simple-complex. He concludes that the simple-complex dimension is dealing with the degree to which the factors in the decision unit's environment are few in number and are similar to each other. Duncan also concludes that the static-dynamic dimension represents the extent to which factors in the decision unit's environment remain stable over time. On the other hand, **Harris (2004)** crystallizes the environment, based on **Duncan's (1972)** study, into three basic elements: munificence, complexity, and dynamism, which is considered a paradigm in the organizational behavior study.

Usually, the environmental change rate is considerably low for stable environments, while it is high for dynamic environments. Furthermore, the dynamic environment will moderate an organization's performance and strategic process, while hostile and dormant environments will lead to opposite reactions from the organization (**Priem et al., 1995**). In a dynamic environment, successful organizations will continue to propose organizational changes using enhanced techniques and newly developed tools in order to face both of the environmental external and internal challenges. **Burns and Stalker (1961)** conclude that dynamic environments require lower formalized and non-centralized organic types of structures. Successful organizations have to clearly set their strategic plan, vision, mission, and both goals and objectives that are consistent with environmental factors.

Complex environments consist of multiple numbers of external variables that significantly affect organizations' performance, while simple environments consist of a few numbers of external variables. Environment uncertainty is affected by the environmental complexity, rate of change, and available resources. Also, it affects the organizations' capability to understand external changes and predict their affect on current operations.

**Deegan and Unerman (2009)** point out that while there is no theory to clarify the differences between international accounting and auditing practice, there are two main models of financial accounting. The first is the Anglo-American model that is based on more involvement of professional accounting bodies, less influence of government, and more capital market mechanisms. The second model is the continental European, which has a limited influence of professional accounting bodies and strong emphasis of governmental bodies. In practice, both audit firms and practicing regulators are not isolated; they are subject to the basic variables of their external surrounding environment. These basic variables can impact audit organizations' opportunities and threats. The audit practicing external environment may be allocated into two main categories, which are strongly interrelated. The first is the specific environment, which mainly consists of Regulatory Organizations, Audit Clients, Local & International Audit Firms, Practicing Associations, and Society. The second, the general environment, consists of International Regulators, International Practicing Standards, Global Economy, and International Society. The general environment indirectly affects both audit firms and practicing regulatory organizations (**Estafen, 1971**). In general, audit firms try to overcome their external environment pressures

through environmental alignment, consolidating their efforts with other business-related firms, joining associations, and framing business groups. This consolidation model has been followed recently by most big audit firms through mergers and acquisitions between each other, which resulted in an oligopoly audit-practicing market with four giant audit firms: PWC, D&T, A&Y, and KPMG.

Figure 2 proposes a structure for both external-specific and general environmental variables:

**Figure 2: External-Specific and General Environmental Variables**



**Source: Researcher**

#### 4.2.1 External General Environment

The external general environment is the forces, either related or non-related to the organization, and events outside the organization's boundaries that may influence its setup objectives. These proposed forces can be presented as follows:

#### **4.2.1.1 International and Local Regulators Context**

Laws, decrees, or treaties may have an international impact that affects a practicing organization's operations. These legal constraints may result in ceasing or revising part of the services provided by audit firms. Professional practicing businesses may also be affected by governmental pressures or released controlling laws. From a practicing point of view, this is typically applicable for government local laws and regulations that organize audit practice interrelation with business and economic activities, such as audit-practicing law, business acts, tax law, and capital market law. During the last decade, many new legislation and regulation acts placed additional responsibilities on both practicing regulatory organizations and audit firms. **Deegan and Unerman (2009)** point out two types of legal systems: The common law system that is mainly based on a small number of accounting and audit-practicing regulations, in view that the practicing regulating rules will be left to professional accountants and auditors. The Roman law system is based on detailed laws and regulations issued by parliament to codify each type of accounting and auditing transactions, therefore, the accounting and auditing profession judgment role will be minimized.

To avoid any creative accounting techniques and future financial crisis, audit-practicing oversight bodies should have more dynamic regulations and financial systems. These dynamic regulations will encourage national and international audit-practicing bodies to redevelop their action plans, and focus more on the necessary practice reforming changes (**Draghi, 2008**).

#### **4.2.1.2 International and Local Economic Context**

Economic globalization resulted in a high level of interconnection between the audit practice organizations and their residual environment. **Allen and Moessner (2011)** conclude that the 2008 credit crisis had many effects on the regulatory behaviors, governments, central banks, financial institutions, and international liquidity policies. Audit firms usually targeted specific economic segments through analyzing market sectors, services, or product demand. Economic fundamentals affect both the audit practicing firms and their clients' performance. A strong growing

economy means more audit assignments and professional services that may be provided by audit firms to individuals and corporations. Furthermore, a growing economy leads to new advanced and sophisticated financial products that require new complex practicing techniques and new regulating rules to organize them.

Both international audit-practicing regulations and international accounting regulations are raised as normal responses to the capital markets globalization and the growth of international investment businesses. Efficiency of capital markets is based on the transparency, quality, and reliability of the publically available financial information. Improving organizations' disclosure quality will help in reducing market asymmetry and enhance market liquidity (**Jain et al., 2008**). Using IFRS and IAS for financial statement preparation will enhance financial transparency and reporting quality. Also, it will help in avoiding any weaknesses associated with local financial standards. **Sikka (2009)** points out the necessity of improving audit and financial statement quality in order to face economic capitalism changes, increase investor confidence, and enhance general economic growth. These improvements are considered as a main part of developing audit practicing environment.

#### **4.2.1.3 International and Local Social Context**

Over the last decades, many debates were raised regarding organizations' societal role. Some of the earliest researchers conclude that organizations are only serving economic targets (**Taylor, 1947**). Others emphasized the importance of non-economic organizational roles (**Drucker, 1954**), while psychologists, sociologists, and organizational behaviorists' correlated organizations' function to manage and maximize internal and external social variables (**Jensen, 2002**). **Hofstede (1991)** points out the importance of ecological fallacy, which assume that generalization of any culture value will be equally applied for all organizations along the society culture.

Organizations' social responsibility and its related functions become more important for businesses. Organizations started to be more convinced of their social responsibilities in reducing operational and business risks (**Middlemiss, 2003**). Organizations' social responsibility focuses on managing different stakeholders' issues,

such as communications, relationships, setting objectives, identifying procedures, implementing policies, and monitoring functions (**Story & Price, 2006**). Social contexts have to be implanted in the audit-practicing culture. Consequently, the practicing culture can be described as a socio-cultural unit that is built on sets of shared professional values, attitudes, standards, beliefs, and operating philosophy characteristics. Both audit firms and practicing regulatory organizations can be described as social systems that are governed by social and psychological rules. Also, they are governed by codes of ethics that limit any behavior influenced by their group's individuals. Therefore, audit firms always provide their staff with ethics training, rewards for ethical behavior, and setup of proper internal control procedures to handle any misconduct.

In general, both audit firms and practicing regulators can be described as a bounded social system with a relative stable interpersonal network that permits the flow of messages smoothly, and enhances the overall system outputs (**Schuler, 1975**).

#### **4.2.1.4 International Practicing Standards**

Historically, before the global spread of IFRS, multinational companies were required to prepare different financial statements, based on each country's reporting regulations, which has always led to different financial results for the same company.

The cultural and institutional differences may obscure the accounting international harmonization's efforts. Therefore, a globalization strategy enforced the direction of harmonization efforts into international practicing standardizations (**Nobes and Parker, 2004**). Practicing standards help both audit firms and regulators to provide efficient services through the use of proper knowledge, techniques, and tools that transform accumulated knowledge and experiences into outputs. The quick changes in practicing standards may lead to an unstable environment, and decrease the quality of audit products and services. Also, standards changes may lead to more sophisticated processes that put pressure on both audit firms and practicing regulators, as they take time from users until they understand how to deal with them and adapt properly.

## 4.2.2 Specific External Environment

In order to gain its legitimacy, rational organizations always try, in a variety of ways, to respond to stakeholder needs. Typically, this includes responding to social and cultural pressures through setting prescribed scripts, rules, classifications, and codes of conduct. **Meyer and Rowan (1977, p. 353)** argue that “organizations incorporate societal legitimated and rationalized elements in their formal structures, in order to maximize their legitimacy and increase their resources and survival capabilities.” The global financial crisis addressed the international financial regulations fundamentals weaknesses, and proposed the necessity of having regional and international regulatory changes that consider the current global economic and financial environment. The new regulations should include more effective vehicles to monitor and evaluate the organizations' international systemic risks.

International governing financial systems can achieve international financial stability through macro-prudential oversight that covers international accounting and practicing regulations. These reforms should be performed through an institutional framework, on a global level, that appropriately allocates responsibilities between local and international practicing organizations. Also, reforms can be executed through proper restructuring of audit practice-specific environmental forces (**Pooran, 2010**).

Specific environments have a direct effect on the ways that audit firms and practicing regulatory organizations conduct their businesses. The specific internal environment's main factors can be proposed as follows:

### 4.2.2.1 Local and International Audit Clients

Audit clients represent the most important internal environmental factors in the audit practice environment. Audit firms cannot exist without its clients' support. Clients are more interested in the reliability of the audit firm's services, which is one of the main characteristics of the products and services quality. Usually, the client is satisfied when service is performed as promised without fail. In audit practicing, reliability should be a desirable and basic feature for business building.

Audit practicing is one of the most complicated and sophisticated professional businesses that requires a high degree of interaction with the served clients. Furthermore, audit clients are the main source of auditing information and knowledge. Due to the audit firms' unique type of services, usually they need to form downstream alliances with their clients to control any change in their demands and keep balance with their societal responsibilities.

Most audit-practicing products are unified, whether national or even international. For that reason, audit firms are required to follow the same practicing standards regardless of their location. Also, audit firms are encouraged through practicing bodies and practicing regulators to apply predetermined basic reactive and proactive strategies, therefore, they have to identify any expected clients' problems, and evaluate their effects on the continuous audit relationship.

#### **4.2.2.2 Local and International Competitors**

An organization's competitiveness framework develops the main assumptions of its culture. **Klein (1977)** concludes it is unpractical to imagine the market without any level of competition. Usually, any substantial changes in market distribution increase the level of market competition.

Competitors in the audit practice business are mainly between professional audit firms working in the same field and providing the same kind of services to different clients; hence, competition should be evaluated based on the audit firm size and the professionalism of the competitors. Because of the audit-practicing unique characteristics and its social role, competition should be regulated, imposed, and monitored through the regulatory oversight organizations. In general, the higher the number of audit firms acting in the market, over a given time period, the higher the level of market competition.

Wide swings in business market shares always led to high inter-organization rivalry and low customer loyalty, which is not the case in the audit-practicing field. Audit clients usually have a high level of loyalty and conformity with their professional service providers. Also, audit clients do not prefer to change their service providers unless there is a serious reason. This high level of loyalty may contradict with professional ethics and impair audit firm independency.



#### 4.2.2.3 *Local and International Regulators*

Audit practicing significantly affects both the community and the economy; accordingly, it should be treated as a highly regulated business. It should be properly monitored by governmental regulatory bodies, local government departments, and commissions. After several attempts of accounting and auditing harmonization, many countries still follow two different tiers of accounting systems that consist of a preliminary legalization system for listed public companies, and a domestic legalization system for non-listed companies. From a cost-effective point of view, the two-tier accounting systems may not be convenient for non-listed private companies and public auditors. Also, it creates many obstacles in the road of global accounting harmonization.

Both international and local governmental practicing regulators are responsible for maintaining an effective practicing environment that supports the professions' role in servicing the society, and protecting public interests (**Crewson, 1997**). Practicing regulations consists of rules that govern the audit profession's procedures and guide their working flows. On the other hand, local and international governmental or non-governmental regulators represent the organizational bodies that monitor and control audit practicing. These bodies embed their goals inside the practicing philosophy, and manage the relationships between different stakeholders. Therefore, practicing regulations play a significant role in the audit-practicing environment through directing auditors' technical procedures.

#### 4.2.2.4 *International Practicing Standard Setters*

Developed communities rely on the vital role of non-governmental informal networks, which is typically represented in the context of group activities that gather similar people through related trust ties and cooperation desires (**Putnam, 2000**). This concept is typically presented in collectivistic organizations or groups that consist of members with generalized ties to other stakeholders in that group. Collectivistic organizations' structure reinforces social and professional networks; also, it unites people within and across businesses through common visions and objectives. **March and Olsen (1989, p. 160)** define the role of institutions, such as collectivistic organizations and groups as "collections of interrelated rules and routines that define appropriate actions in terms of relations between roles and situations."

Professional groups can shape their members' behavior and beliefs through using formal and informal tools (**Barnard, 1938**). **Perry (1990)** concludes that group membership is always identified through members' active involvement in business functions. As a result, membership is more related to the active involvement rather than education level that is typically completed prior to joining the group. Generally, the professional membership is a type of socialization that parallels the employee's experience and supports members' organizational success through use of professional identifications.

On the other hand, audit and accounting standard setters are a number of concerned individuals who band together, including non-governmental controlling organizations, in order to organize audit-practicing businesses. Accordingly, international standard setters can influence audit practicing and force professions to change their practice approaches. Moreover, non-governmental controlling organizations, such as audit-practicing associations that monitor and control audit practicing and setting standards, can be classified as advocacy groups. These groups are mainly based on their internal integration, which set up the groups' collective identity and operating procedures. Also, they enforce membership requirements, codes of ethics, professional norms, and prescription business rules.

### **4.2.3 Environmental Uncertainty**

The effective implementation of accounting and auditing instruments should be through an energetic environment (**Tillema, 2005**). In view of that, both audit firms and practicing regulatory organizations need to interpret their environment properly, and consider the different environmental variables. Typically, organizations should have enough experience and capacity that support its capabilities to interpret the surrounding uncertain environment, and to enhance organizational environment fitting.

International reform of the audit profession is a static phenomenon, while the global audit profession regulatory environment is highly complex. Therefore, studying environmental uncertainty should not only be based on the practice regulatory

organizations that monitor the profession, but also it should include both local and international oversight boards, in addition to the audit-practicing firms that constitute the shaping boundaries of the audit arena (**Richardson, 2009**). However, some researches, such as **Kreiser and Marino (2002)**, argue that environmental uncertainty is fundamentally meaningless, as environment uncertainty proved to have significant effects on organizational structures, operating strategies, and work flows. Therefore, **Whittington (1988)** argues that an organization's actions are subject to environmental structure. Though **Hartmann (2000)** studies the effects of environmental uncertainty's external factors, he concludes that accounting data is the most important explanatory variable that helps in evaluating business performance. Environmental data and information absence will definitely lead to environmental uncertainty, which has two main dimensions:

- **Environmental complexity:** environment is classified into Simple or Complex based on its number of external variables, and their interrelationship.
- **Environmental stability:** environment is classified into Stable/Unstable based on the speed, predictability degree, and its exchange pattern.

**Gordon et al. (2000)** conclude that organizations operating in unpredictable environments should have a quick-changing capability to survive, which encouraged **Prendergast (2002)** to conclude that within uncertain environments there should be significant organizational authority delegations, while under stable environments orders monitoring should be controlled by the principal.

In view of that, we may conclude that environment uncertainty debates are mainly focused on three major aspects:

- **1st** Degree of sophistication and number of variables in the environment that makes it more difficult;
- **2nd** The environment stability and predictability; and

- **3rd** The availability of resources that are mainly relative to the number of competing organizations.

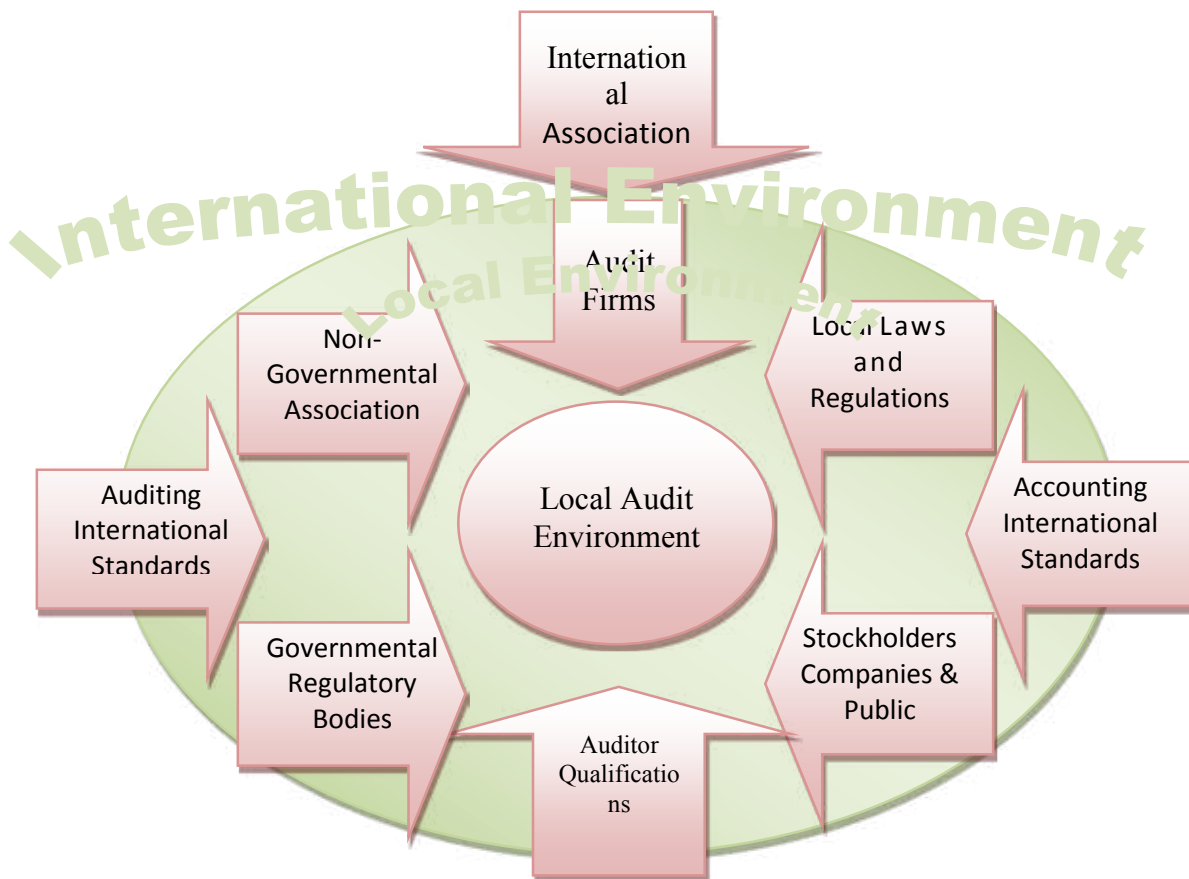
In general, many factors can trigger changes within the organizational environment, such as regulations changes, legal environment, quality expectations, productivity changes, new technologies, customer satisfaction, and competition. However, environmental uncertainty leads to unpredictability, and is an associated phenomena that helps in supporting decision-making, increasing effectiveness of leadership, and develops management behavior (**Atuahene-Gima & Li, 2004**). Also, environment uncertainty studies help in increasing the government efficiency in selecting its functions domain (**Leiblein & Miller, 2003**).

Strategic consensus always requires environmental scanning. Thus, professional organizations have to continuously scan their environment for any important new variables that may affect their business or reduce the uncertainty degree. Volatility of some environmental variables should also be used as indicators in measuring complexity (heterogeneity) and dynamism (variability) (**Ambrosini & Bowman, 2003**). Environmental scanning will help both audit firms and practicing regulatory organizations to identify any environmental threats, opportunities, and the proper required strategic decisions. **DiMaggio and Powell (1983, p. 150)** propose a connectional framework that studied the pressures of internal environmental variables and changes that organizations may face. They conclude that “under normative isomorphism, the professional affiliations and/or standards of internal employees' stakeholders drive the organization to adopt structures consistent with the profession's cosmopolitan, and value rational orientation as opposed to local instrumentally rational goals.”

In order to study the environmental uncertainty phenomena and its effects on the audit-practicing environment, we proposed a conceptual practice environmental design that consists of the main internal and external environment dimensions, as presented in Figure 3. The concept design tried theoretically to identify the main

environmental constructs/variables that may affect the local audit-practicing environment based on the previously discussed literatures and researches. Also, we tried to incorporate in each construct/variable to the expected sub-dimensions that may have a similar effect on the overall practicing environment. The new measures' constructed validity was assessed using perceptual data from professional auditors and practitioners. Because neither a single approach to conceptualize the audit practice environment nor to measure it has received widespread acceptance, we have been unable to build comprehensive and coherent literature about the audit practice environment and its impact on the profession's behavior. We conceive our proposed conceptual constructs to be multidimensional, and construct general measures in our empirical research to reflect this approach.

**Figure 3: Conceptual Practicing Environment Design: Internal and External Environment Dimensions**



**Source: Researcher**

## **Chapter 5**

# **Current Environment of Audit Practicing In Egypt**

## Chapter 5: Current Environment of Audit Practicing in Egypt

Audit professions have a central role in economic development, investment evaluation, and companies' guidance. During the last decade, international markets had been developed rapidly, which was reflected in the Egyptian economy that achieved high rates of growth until 2011. Currently, both the local and global economy are facing many financial structural challenges, particularly for both auditing and accounting services. Today, because of the globalization of services and the efficiency of communication tools, local Egyptians' professions and practicing organizations have to compete head-on with their international counterparts.

The GLOBE research project studied the culture across a large sample of countries, including Egypt as one of the Middle Eastern countries. The GLOBE study was based on an approach similar to Hofstede culture classifications' basic values. The GLOBE classification of the Egyptian culture, which is summarized in the following table, indicates that the Egyptian culture revolves around the masculine community that believes in groups working with an average degree of capability to change. This community is built on respecting of hierarchy, leadership, and a low degree of potential risk planning.

### Project GLOBE Classification of Egyptians' Societal Cultures

Table 4

	Low-score	Mid-score	High-score
Gender egalitarianism	Egypt		
In-group collectivism			Egypt
Humane orientation		Egypt	
Uncertainty avoidance	Egypt		
Power distance	Egypt		

Source: Javidan et al., 2006, pp. 67–90.

Currently, small- and medium-size Egyptian audit firms are not obliged to comply with stringent standards, while big firms have to follow rigid standards due



to their associations with international audit firms. During the last decade, Egyptian authorities, represented in the Ministry of Finance, tried to set up a standardized framework for audit practicing through the launch of Egyptian Auditing & Accounting standards. Local regulators exercised more efforts to align and narrow the compliance gap between local businesses' financial reporting standards and International Accounting and Auditing Standards, even though small and medium local audit firms do not support the regulators' developing efforts. Currently, local regulators do not activate proper tools to control and review audit-practicing business activities. The Egyptian regulatory bodies and standards setters' efforts were more effective in relation to both financial institutions and publicly listed companies. Local regulators were able to achieve improvements by having these companies comply with local published accounting standards, which were based on IFRS as a benchmark. The reason behind these improvements was related to the fact that most of the listed companies are audited by local representatives of international audit firms. International audit firms always force their local representatives to comply with home-office operating standards and quality control rules.

The current amended Egyptian companies' law requires all companies to provide their shareholders with an acceptable volume of information during their annual meeting, such as audit report, balance sheet, profit and loss accounts, and the statement of cash flow. Applying a modern legislative framework seems to be required in order to achieve further improvements. In addition, the application of a new audit practice regulatory framework will fix the current law's weaknesses, enhance the practicing environment, and provide enforcement mechanisms to monitor audit professions' compliance with applicable accounting and auditing standards. A new proposed Accounting Practice Law has been drafted to determine all the principles of accounting and auditing, but have not yet been ratified (**Dahawy et al., 2002**).

Another serious problem that faces the Egyptian practicing environment is the scarcity of experienced professional auditors. This problem has recently been raised because of the deteriorating educational quality, the decreasing of training programs, outdated practicing laws, the weakness of regulatory bodies, and the limited role of professional associations. On top of that, the Egyptian practitioners are not required to

follow any code of ethics, neither locally developed ones nor the IFACs' ethics requirements. This deficiency damaged the overall Egyptian local audit practice environment.

The following sections present a discussion of the main factors that may affect the Egyptian local audit practice environment.

## 5.1 Laws and Regulations

The legal system implemented in Egypt is taken from the French legal system, which is basically the Roman law system. Egypt was occupied by France during the period 1798–1801. However, following French occupation, Egypt was occupied by Great Britain in period of 1882–1956. The Egyptian legal system did not change to the Britain common legal system.

During 1991, the Egyptian government started a comprehensive Economic Reform and Structural Adjustment Program. Launching of this program was supported by the World Bank and the IMF. Egyptian authorities were aware that the sustainability of the program should be based on the implementation of an effective financial regulatory framework that supports credible corporate information, and uses internationally accepted accounting and auditing standards. To achieve this target, the Egyptian government launched several initiatives to reform corporate financial reporting and disclosure rules, as well as practicing regulations, and accounting and auditing standards. These improvements have not yet been finalized (**Rahman et al., 2002**).

A limited liberalization of Egyptian accounting services has been initiated since the last decade. Currently, most of the international audit firms are represented in Egypt. International audit firms can locally operate only through local representatives. Under the current practicing law, non-Egyptians are not allowed to locally practice in the audit profession.

On the other hand, the Egyptian Central Auditing Organization Law, number 144/1988, regulates audit rules for governmental organizations. It instructs on auditing all governmental departments, ministries, agencies, public-sector enterprises, and private companies in which public ownership interest is higher than 25 percent. It is directly reported and supervised by Parliament, which submits all of its published reports to a specialized committee for review.

### 5.1.1 Governmental Regulatory Bodies and Laws

Accounting Practice Law number 133/1951, and its amendments, represent the main law governing professional accountants and auditors. However, the law is considered out of date by most practitioners.

About ten years ago, the Ministry of Finance started preparing a new proposed practicing law. Both the Egyptian Syndicate of Accountants and the Egyptian Society for Accountants and Auditors' role in the newly proposed law is still under discussion. The delay in finalizing the proposed Accounting Practice Law has stalled efforts to improve accounting and auditing practices. The new proposed law recognized the importance of introducing a professional qualification exam for accountants; besides, the law legalizes licensing of individual auditors and audit firms as the only authorized providers of statutory audit services. The law also emphasized the importance of coordination between professional accountancy organizations through establishing the accounting and auditing council. Also, the law enhances auditors' independence and proposes mechanisms to resolve disputes between auditors and audited entities.

Under the current existing practice law, Registration Committee for Accountants and Auditors is categorized under the supervision of the Ministry of Finance. The committee is responsible for registering practicing auditors, and has a list of more than 30,000 registered auditors. The current practicing registration rules do not require proper practicing experiences in a registered training office. The Committee accepts any applicant's certificate of experience, even though it may be issued from any small non-regulated audit firm.

The Egyptian Stock Exchange does not have the legitimate authority to enforce listed companies to follow International Financial Reporting Standards for their issued financial statements. It also has limited authorities and tools to impose sanctions against non-complying and financial reporting violating companies. However, the Capital Market Authority (CMA) has some limited sanctions authorities and tools. On the other hand, The Central Bank of Egypt relies on the bank's statutory auditors to ensure financial institutions' compliance with accounting and disclosure requirements. Currently, Egypt is applying the Egyptian Accounting Standards, which are complying with International Financial Reporting Standards (IFRS), in most of its parts, except for five accounting standards that are totally different from IFRS interpretations.

The Central Auditing Organization's main role is to support the Parliament's controlling job for governmental funds and public body performance. It audits governmental unit operations and reviews the implementation of governmental plans. Recently, The Egyptian Central Auditing Organization took significant procedures to coordinate the public-sector accounting and auditing standards with the internationally accepted standards. Furthermore, both The Ministry of Finance and The Central Auditing Organization are working together to ensure public-sector companies complying with accounting and auditing standards. The current capabilities of the Central Auditing Organization are neither strong enough to investigate government organizations' compliance with accepted public-sector accounting standards, nor to support those organizations' performance.

### **5.1.2 Companies' Law**

The current applied Egyptian Companies' Law does not cover both accounting and auditing standards. It requires conducting of external audits based on the outdated Accounting Practice Law, number 133/1951. The recent amendments of the Companies' Law stated that all companies should follow the same accounting standards used by the Capital Market Authority's regulated companies. The law also stated that shareholders' annual meeting should evaluate the auditor's performance and assign a new auditor, or renew the engagement for the existing one. The law required auditors to attest on the following subjects during the shareholders annual meeting, whether

- 1- The company maintains proper accounting records;
- 2- All legal requirements have been applied to the accounts;
- 3- All information and evidences for accomplishment of duties have been collected; and
- 4- The financial statement is fairly present in the entity's financial condition and results of operations.

Moreover, both of the new companies' law amendments and the current practicing law do not include any detailed provisions that regulate the auditors' independencies and their relationship with the auditee, or responsibilities to third

parties.

### 5.1.3 Banking Law and Capital Market Law

The Banking Law, number 163/1957, stated that banks should follow Egyptian accounting and auditing standards, and guidelines established by the Central Bank of Egypt. The Central Bank of Egypt (CBK) usually reviews banks and financial institution operations. CBK also has the rights to review the banks' external auditors' works and financial statements before issuing them to the shareholders. CBK may ask banks to provide any type of special reports as it represents the main authority that controls banks' operations in Egypt (**Wahdan et al., 2005**).

The Capital Market Law requires all listed companies to prepare their financial statements in compliance with the International Financial Reporting Standards (IFRS). On the other hand, the Ministry of Finance Decree, number 503/1997, mandated Capital Market Law articles by imposing all local listed companies to use the Egyptian Accounting Standards. However, in the event of absence of Egyptian Accounting Standards regarding any accounting treatment, companies can use IFRS. The Capital Market Authority states that all listed companies have to publish their financial statements in at least two public newspapers. Effective August 2002, the Capital Market Authority imposed various punishments against violators of financial reporting and disclosure requirements. The punishment rules aimed at ensuring that the preparation and presentation of financial statements are complying with accounting, legal, and auditing standards. Existing punishment rules specified that if a listed company violates accounting and disclosure requirements, the Capital Market Authority (CMA) is empowered to ask the company to correct and reissue financial statements. If the company refuses the request, the Capital Market Authority can enlist a third party to redo the financial statements at the companies' cost. Also, the CMA can suspend or cancel stock market listings of violators. At present no arrangement exists for imposing fines, penalties, or similar sanctions on the violated companies or auditors (**ROSC, 2001**).

## **5.2 Non-Governmental Associations and Practicing Organizations**

In the late 1950s, the period of socialist nationalization of auditing and accounting, the audit business almost came to a standstill. The new Egyptian accounting associations formalized and began to have a key role in the local practicing environment. Also, The Central Auditing Organization became responsible for public-sector auditing. In the middle of 1975, the Egyptian government started an open-door economic liberalized policy. Also, the government initiated several improvements in the accounting standards and auditing practices (**Wahdan et al., 2005**).

### **5.2.1 Non-Governmental Associations “ESAA & Syndicate Accounts Unit”**

The Egyptian Society of Accountants and Auditors (ESAA) was established in 1946 and is managed by a Board of Directors. ESAA is the local accredited association of chartered accountants and auditors. The association is recognized by the International Federation of Accountants (IFAC). Both ESAA and the Syndicate Accounts Unit are responsible for developing the Egyptian professions, enhancing audit educational tools, and implementing practicing standards. ESAA associate membership may be obtained if an accountant can satisfy one or more of the following conditions:

- 1- Membership in the Institute of Chartered Accountants of England and Wales, or another acceptable foreign professional bodies;
- 2- Doctoral degree in accounting or auditing with three years of full-time practicing experience; and
- 3- At least three years of full-time practicing experience in a licensed practicing audit firm under direct supervision of a Society member; in addition to successful completion of the society’s two-part exams. The first part of the qualifying exam is performed after completing half of the practicing period, while the second part is completed at the end of the three-year practicing experience.

Egyptian audit-practicing function does not totally conform with International Auditing Professional Standards. ESAA is not functioning as a self-regulating body as per IFAC recommendations. ESAA has no authority to establish a disciplinary

committee that has the power to ensure that its members are complying with the rules and standards of professional conduct (**Abd-El Salam & Weetman, 2003**).

Recently, ESAA published the local independency and ethics code of conduct. The ethics code imposed any auditor from auditing the same company for more than five years, or accept expensive presents that may impair his or her independence. The code forbade resigned audit staff from joining any of the audit firms' clients during the consecutive three years following their resignation. In general, there is no clear mechanism to impose the recently issued codes on practicing auditors.

### **5.2.2 Audit-Practicing Organizations & Audit Firms in Egypt**

Egyptian audit-practicing structure only permits local firms to be licensed, however, all of the big international auditing firms are presented in the Egyptian market through partnership with local professions. International auditing firms practicing in Egypt are more familiar with both Egyptian accounting standards and IFRS. Accordingly, companies audited by international audit firms' local representatives will comply with IFRS requirements.

Most local audit firms, except those that have an international audit partnership, are issuing financial statements and audit reports without performing any quality-assurance procedures or being audited by peer reviewers. Egypt currently has no structured regulations for audit quality assurance or practicing inspections. **Rahman et al. (2002)** conclude that most of the local audit firms' clients mistakenly interpret financial statements compilation reports as if it is an audit report. Due to the local culture and weak professional regulations, many practitioners satisfy their clients' needs by circumventing rules of professional conduct. The auditor might try to keep the client happy by charging him or her additional fees to provide an audit report, however, the auditor did not conduct any of the audit standards' required procedures.

Egyptian auditors' independency is dramatically affected by the nature of



the closely held companies' structure. Most of the Egyptian companies are family business that are controlled by family members through the majority of issued capital shares. Also, the companies' Board of Directors and key management do not separate between auditing and consultancy services provided by auditors (**Fawzy, 2003**). In practice, most local small- and medium-size audit firms have little or no awareness of international best practices, conflict of interests' rules, independency rules, and code of conducts. Moreover, they are not imposed to follow any local code of conducts, or IFAC Practicing Code of Ethics (**Dahawy et al., 2002**). On the other hand, most of the Egyptian big-size audit firms have qualified staff, who are always under pressure, as they serve more clients than their capacity. The high pressure negatively affects the audit services quality and final audit results (**Abd-Elsalam & Weetman, 2003**).

### **5.2.3 Practicing Auditors in Egypt and their Qualifications**

Based on the current audit-practicing law, individuals who join audit public practice should be registered with the General Register for Accountants and Auditors. Currently, there is no required qualification exam for individual registration or licensing, unless the individual wants to have a shortcut to the higher level of public accounting license that gives him the right to publically audit both joint stock companies and financial institutions. The registered person should have at least a bachelor's degree in accounting. Individuals begin by registering as a trainee accountant, then becoming licensed as a first-level accountant after three years of practicing under the supervision of a licensed auditor. The first-level accountant registration authorizes the holder to publically practice auditing for partnership and sole-proprietorship companies. After completing an additional five years of practicing experience, the first-level accountant may receive his or her final registration certificate that grants authority to act as a public accountant for joint stock companies and financial institutions. Individuals may also register directly with the Egyptian Society of Accountants and Auditors as a student member, which qualifies them with the higher level of audit-practicing license, after passing both the intermediate and

financial qualifications exam.

Currently, there are many practicing licensed auditors, non-members of the Egyptian Society of Accountants and Auditors, who lack necessary professional competence for providing high-quality auditing services.

The main reason for incompetence and lack of knowledge between Egyptian public accountants mainly results from the university's poor educational quality, and outdated accounting and auditing curriculums that mainly focus on preliminary topics and applications without considering the breadth and depth of the studied subjects. Also, there is a limited number of qualified instructors, not considering teaching IFRS and IAS as a basic course for accounting students. All of these negative facts led to poor knowledge and continuous deterioration of Egyptian educational accounting programs. In addition, the Egyptian's current public practicing licensing system does not impose any kind of mandatory continuous practicing education for renewing their practicing license.

#### **5.2.4 Accounting and Auditing Standards Committee**

In 1997, the Egyptian Ministry of Foreign Trade issued a Ministerial Decree, number 478/1997, which established the Permanent Committee for Accounting and Auditing Standards. The Committee is officially responsible for setting both accounting and auditing local standards. The Committee started by partially customizing and translating international accounting and auditing standards into Arabic language. These standards have become the basis for drafting the Egyptian accounting and auditing standards. The committee working mechanism is starting with introducing the standard to the Permanent Committee members for discussion and adoption; subsequently, the committee sends it to the Ministry of Foreign Trade for approval and issuance through a ministerial decree (**Wahdan et al., 2005**). Currently, there are 22 issued Egyptian Accounting Standards and six Auditing Standards. The six Auditing Standards focused only on audit planning and reporting without considering other audit subjects that are covered by International Auditing

Standards (ISA), which indicates the lack of operating strategy of the committee responsible for planning, researching, and drafting accounting and auditing standards (**The Ministry of Foreign Trade, 2003**). In general, accounting and auditing standards' compliance is constrained by lack of capacity between public auditors and accountants who are responsible for preparing financial statements, in addition to an inadequate regulatory enforcement system. Despite the many developing efforts led by the Egyptian Syndicate of Accounts, the road is still long due to the lack of required knowledge to apply accounting and auditing standards, and the high cost of developing a professional accounting education and designation system.

## **Chapter 6**

# **Proposed Factors that Affect the Audit Practice Environment**

## **Chapter 6: Proposed Factors that Affect the Audit Practice Environment**

Litigations against accountants and auditors increased significantly during the last decade. The impact of these plentiful litigations on the global audit practice was hard to judge accurately. Nineteenth-century literature reveals a strong concern regarding the uncertain nature of auditors' responsibilities. There were many calls to develop a clear definition of the auditor's role and responsibilities (**Chandler & Edwards, 1996**). The first professional auditor negligence law case was in the 1890s, which raised many concerns regarding auditors' followed methodologies, their roles in society, and the effects on the economy. Recently, audit practicing was subject to much criticism due to the continuous chain of negligence. This criticism interpreted in massive global litigations against auditors' failures to properly reveal the audited companies' financial health, and related damage to public interests (**Lowell, 1995**).

Audit function and accounting information reliability are crucial to financial statements' users. They affect decision-making and a broad range of societal parties' welfare. With declining government controls on the economy, independent audits became much more important. Currently, public auditors are servicing various users and different beneficiary society groups. These groups of users usually have different conflicted interests, and different expectations of auditors' performance, which should be considered by auditors during the phases of audit engagement. Typically, managements' publishing information gain their credibility through auditors' professional competence, objectivity, and independence (**Danielle, 2003**).

Globalization has been founded through three stages. The first stage was based on the European military expansion, while the second stage was based on the multi-national corporations and integration. The third stage, which commenced in 2001 and carries on until now, is based on technological revolutions and communications. Currently, the world turned into a big network, which created significant economic and financial challenges (**Friedman, 2005**). **Nobes and Parker (2008)** point out that globalization measurement is subject to national boundaries that create relationships with the international markets, such as international trading, tourism, and technological connectivity.

Economy globalization has a great powerful influence over accounting and auditing professions, which increased interactions between regulators' non-governmental organizations and governmental bodies. This type of interaction will support future development of the global audit function, and will also maintain a strong global reputation of audit practice (**Humphrey et al., 2009**). Therefore, the success of any global financial reforms require a high-quality global audit practice system that is consistent with audit-practicing comprehensive regulatory framework (**Hegarty et al., 2004**). This integration trend encouraged international audit-practicing regulatory bodies to associate different local and international audit professions in order to establish a unified international voice.

**Nobes & Parker (2008)** argue that a country' legal systems, taxation systems, and cultures influence the local accounting practices' model, while **Barth et al., (2006)** conclude that the legal system influences both operating environment and audit practice methodology. In view of that, one-size practice regulation does not fit all environments. A country's local accounting environment is usually structured based on the followed political, social, and economical governing culture. Otherwise, the structure of the audit-practice culture is identified as a controlled hierarchy, which mainly relies on a highly structured system, built on rules, procedures, and formal policies to govern the different parties' behavior, and hold the professions' groups together. This high-performance culture is vital for the success of the audit practice, hence the societal expectations of formalized practicing environment should be implanted in the methods of audit professions (**Abbott, 1988**).

Harmonizing between society expectations and practicing methods may be achieved by having appropriately credentialed audit-practice organizations, with appropriate degrees of discipline, proper certification procedures, and a high-quality academic education (**Scott, 1995**). Based on the public policy consideration theory, different public interested parties have to recognize the merits of independent auditing under different changeable social and economic conditions. Therefore, both auditors and audit beneficiaries have to consistently support independent audit expansion concepts. Also they have to encourage deregulation of audit-practice activities.

Audit has an important economic role that may be damaged in case of applying inappropriate practicing laws or regulations. Currently, there is no recognized academic theory that either measures the audit-practicing environmental constructs, their expected correlations, or their affects on audit function. Most of the academic researches only focus on the audit-practice environment's governing laws and regulations, without paying attention to any other variables that construct the environment. Based on the literatures discussed in the previous chapters, mainly the contingency models presented by academic researchers, such as **Thompson (1967), Lawrence & Lorsch (1967), Jelinek (1977), and Laird & Dennis (1979)**, we propose a conceptual model, as presented in Figure 3, in order to empirically test the Egyptian local practice environmental variables. **The following sections discuss the key local environmental variables.**

## **6.1 Local and International Non-Governmental Audit-Practicing Organizations**

### **6.1.1 Non-Governmental Organizations**

A professional body is a group of related people that are defined by their commanding respect, high trust, act in the public's interests, and subordinate each group member. The professional body typically includes a variety of expertise that are independent from the government, thus it can immediately respond to any faced subjects (**Ward, 2004**). Due to the businesses globalization and recent concerns about audit-practice efficiency, audit professions are facing strong challenges, including the need to articulate self-regulation core principles that can be followed by different cultures and services industries.

Weaknesses of professions' self-regulatory associations always reduce their enforcement role and negatively affect the practicing environment and economic performance (**Coffee & Berle, 2001**). In order to control and monitor audit professional bodies, and limit their negative effects, many countries established independent oversight bodies that regulate the auditors' activities and enforce compliance rules. Typically, government oversight bodies can be instituted by legislation and enforced by the disciplinary process.

Threats of litigation usually prevent practitioners from performing negligent audits. Also, it increases pressures on the professional bodies and non-governmental organizations to set up proper controls and standards to protect the reputation of national practice. This subject represents the core of the self-regulation concept (**Chandler & Edwards, 1996**). Due to the specialty of audit practice, which requires professional knowledge, only professional personnel can understand and conclude about another professional's actions, morality, and performance (**Low et al., 2008**). This unique trait shows the importance of audit professions' self-regulation, and the necessity of setting up proper practice education and licensing qualification systems (**DeGeorge, 1999**). **Lovell (1995)** concludes that improving human judgmental skills will enhance people's moral decisions, which is better than setting up imperfect rules that people consider as commandments. **Rockness and Rockness (2005)**

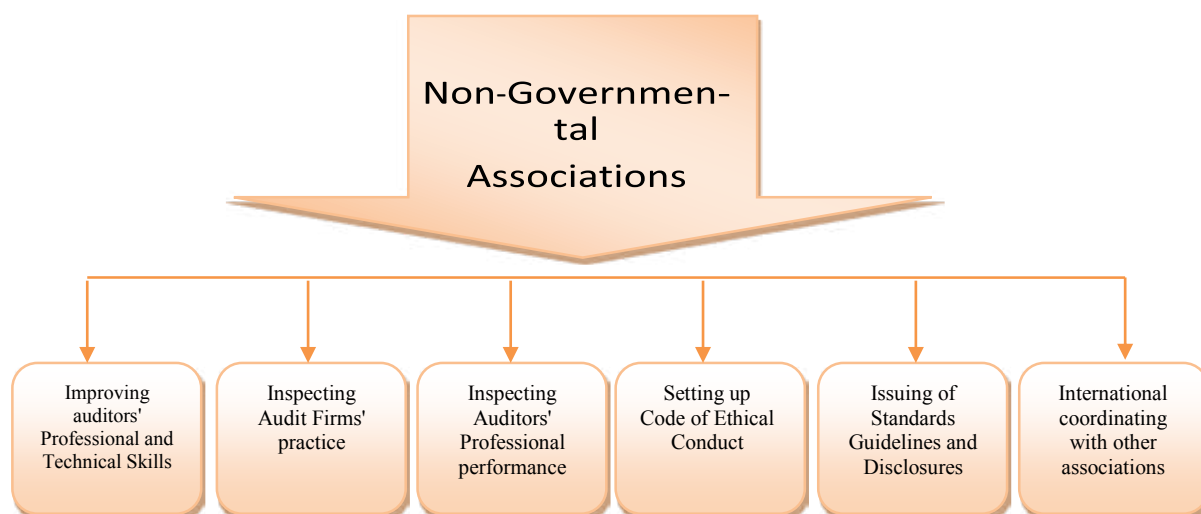


argue that the prescribed codes of ethics only define the criteria of required social and professional behaviors, while setting up ethical behavior rewards and punishment systems should be incorporated within the audit practice culture and internal controls. The non-governmental organizations' role in setting up and supporting ethical codes of conduct becomes more important, as it helps them in isolating members' improper behavior.

The structure of non-governmental regulatory agencies is based on the concept of the society, which is supporting the audit-practice environment. The political theory assumptions considered interest groups, such as non-governmental regulatory agencies, as piecemeal pressure groups over the government policy makers (**Rauch, 1995**). Also, non-governmental audit-practicing organizations enable the public to evaluate auditors' quality by certifying their competences, monitoring their continuous independency, and setting up audit regulations and codes of ethics (**Olson, 1965**). The non-governmental practicing organizations' ethical philosophy, and practicing codes of conduct, enhance professions' ethical culture, reputation, and branding audit image. In general, non-governmental audit-practicing organizations encourage their members' ethical behaviors that reflect high moral standards, and resist members who defend the ethical codes (**Lovell, 1995**).

Figure 4 proposes the non-governmental Audit-Practicing Organizations' important functions, which may affect the audit environment, such as:

- Improving auditors' Professional and Technical Skills
- Inspecting Audit Firms' practice
- Inspecting Auditors' Professional performance
- Setting up Code of Ethical Conducts
- Issuing Standards Guidelines and Disclosures
- Internationally coordinating with other non-governmental and governmental organizations

**Figure 4: Non-Governmental Practicing Organizations**

**Source: Researcher**

In order to enhance the efficiency of non-governmental practicing organizations and increase their effectiveness, we need to start with implementing a series of principles, such as:

- Clearly identifying non-governmental practicing organization responsibilities;
- Adopting the non-governmental practicing organization's independent operation functions, accountability powers, and consistent regulatory processes; and
- Providing non-governmental practicing organization with adequate powers, qualified staff, and proper resources to enable them to fulfill their goals.

Typically, non-governmental practicing organizations regulate audit professions through setting up memberships' required education, admission standards, practicing ethical standards, and the disciplinary actions policy (CICA, 2005).

### 6.1.2 Non-governmental International Audit-Practicing Organizations

The current audit-practice scene resulted in dramatic changes for financial reporting underlying methodology and forms. These changes are presented in the practice-applied ethics. The proper communications between audit-practicing organizations and their members will help them to understand and implement any new standards or ethical regulations (Australian Accounting Research Foundation, 2002). Also, the quick development of global financial markets increased the

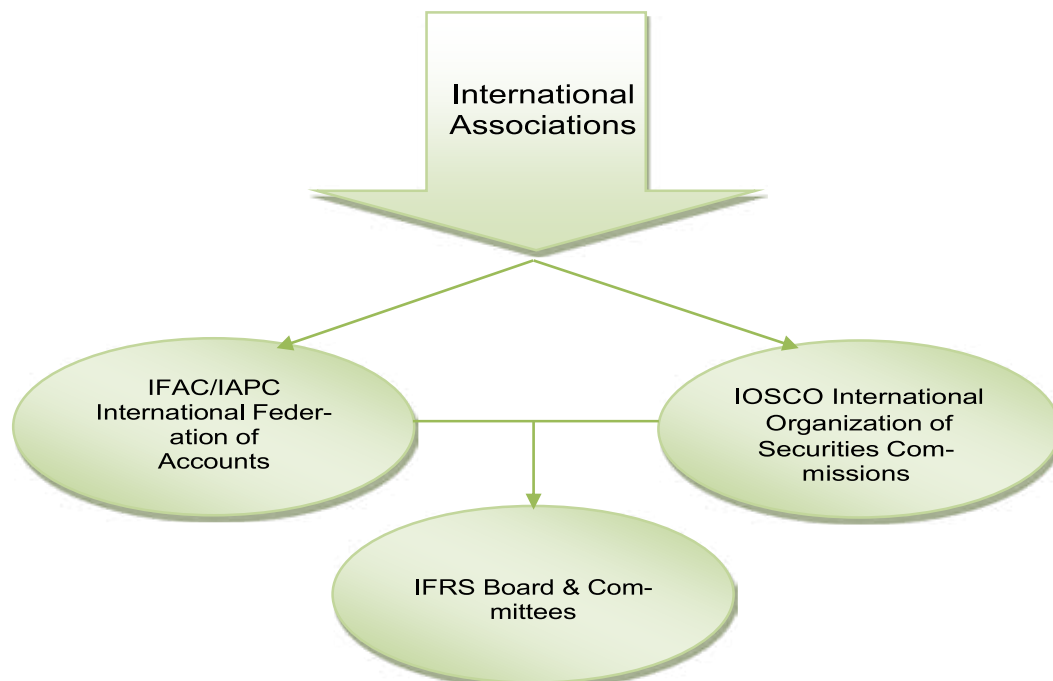
desirability of international unified accounting and auditing standards that can support professional developments, such as:

- 1- Structuring of financial statements preparation and presentation standards;
- 2- Following of comprehensive reporting's' language that respond to users' needs and reduce misleading probabilities (**IFAC, 2003**).

National regulators may support or impede companies from issuing internationally comparable financial statements. In general, non-governmental organizations support the efforts for financial accounting and auditing unification. Audit and accounting internationalization strategies requires clear practice standards, codes of conduct, close monitoring procedures, effective laws, and common regulations. International audit and accounting bodies' usually focus on setting up reporting rules, while enforcing these rules is the role of national bodies and regulators. Global financial reporting harmonization requires effective coordination between regulators, governments, stock markets, standard setters, accounting professions, and financial services providers (**Pendergast, 2005**). **Nobes and Parker (2008)** debate that accounting and auditing harmonization requires standards that fit all points, which encouraged many national regulators to amend their local standards to comply with the international ones. This process will have strong effects on many countries' local regulations. **Gray (1988)** tries to use the basic culture dimensions, which is widely applied by many practice organizations, to explain global differences in auditors' and accountants' behavior. He argues that many local accounting frameworks encourage following of international standards.

Figure 5 proposes the most important international non-governmental organizations that influence the audit-practicing environment:

- “IOSCO” International Organization of Securities Commissions;
- “IFRS” International Financial Reporting Standards Board & Committees; and
- “IFAC” International Federation of Accounts.

**Figure 5: International Non-Governmental Organization**

**Source: Researcher**

### **6.1.2.1. International Organization of Securities Commissions (IOSCO)**

Accounting and auditing standards development must be based on the capital markets' minimum required information, otherwise standards will not effectively support the market regulatory tools.

The Securities and Exchange Commission (SEC) is a governmental agency that has an important role in supporting investors' decisions through providing updated reliable financial information. SEC typically imposed listed companies to file their periodic audited financial statements, then examined these statements for completeness and adequacy before permitting companies to continue selling their securities. The SEC also protects public interests through its involvement in developing accounting and auditing standards, setting financial regulations to prevent companies from being misled, and enhancing information transparency.

In order to reduce risks associated with any market failures, IOSCO requires market intermediaries to use effective internal operational procedures and transpar-

ency vehicles that protect investors' interests. Also, it encourages regulators to structure efficient legal forms and disclosures for different financial markets.

Most of the provincial and national securities commissions (SEC) are members of the International Organization of Securities Commissions (IOSCO). IOSCO members are concerned with securities that are issued by a company in one country and sold in another. IOSCO principles and codes establish a stable environment for financial systems to function independently from any commercial or political pressures. Also, IOSCO standards present the regulators' responsibilities in an objective and clear way.

On the other hand, IOSCO members have to ensure that securities providers are using International Accounting and Auditing Standards in their submitted financial reports to support quality, sufficiency, and appropriateness of financial statements submitted for cross-listing. In order to achieve its targets, and strengthen the international financial systems, IOSCO arranged its efforts with the International Accounting Standards Board (IASB) to establish a formed Financial Stability Forum body (FSF). FSF already issued 12 key standards and codes that are totally supported by IOSCO.

#### **6.1.2.2 *International Financial Reporting Standards (IFRS) Board and Committees***

Financial reporting forms are different from one country's culture to another, which increased professional judgments and led to significant variances in accounting treatments of the same financial transactions. Accounting implementation variances encouraged International Financial Reporting Standards (IFRS) to internationally unify the accounting treatments through developing globally accepted standards (**Nobes & Parker, 2008**). Since 2005, Accounting Financial Reporting Standards (IFRS), issued by the International Accounting Standards Board (IASB), became the accounting standards that were implemented by many countries as a single global accounting language for capital markets. The new IFRSs are one-size-fits-all standards, which encouraged emerging capital markets and Anglo-American countries to apply the IFRS (**Zeghal & Mhedhbi, 2006**).

**Hegarty et al. (2004)** point out that there is an existence of clear-based environments that support the IFRS's successful implementation. Most local standard setters and regulators became involved in international reporting harmonizing efforts, as the local standard setters target to develop global financial reporting standards and accounting regulations through joining the International Accounting Standards Committee (IASC and subsequently the IASB). The IASC represents the global standard setter and gaining support of the worldwide Security Exchange Commissions (SECs), and the International Organization of Securities Commissions (IOSCO). Therefore, IASC has enough influence to enforce the use of IFRS' (**IASC, 2000a**).

A company's decision to implement IFRS is subject to its local institutional framework (the body of accounting law, accepted practice rules, as well as the local institutions that formulate and enforce these requirements). Typically, the local regulator's role is to set up efficient steps that support the proper implementation of IFRS. **Jeffreys (2002)** proposes the following steps:

- Choosing standards implementation effective dates, which may be deferred for small-size companies; and
- Setting up a detailed responding mechanism to face any of the users' concerns, and guiding detailed implementation based on each company's own circumstances.

### **6.1.2.3 International Federation of Accounts (IFAC)**

Auditing standards are a key factor in regulating audit professions. They support public interests concepts, and provide unified measuring criteria for practicing services. Audit beneficiaries have different understandings of audit scope. They assume a wider range of auditor's responsibilities, as they believe that the auditor is obliged to protect their interests through detecting and reporting frauds or irregularities (**Epstein & Geiger, 1994**). Professional responsibility supports the development of practice auditing standards that help professions understand the stakehold-

ers' concerns and meet their expectations (**Porter, 1996**). The widespread multinational organizations, and their need to consolidate various countries' subsidiary financial statements, raised the importance of unifying the internationally followed audit techniques and methodologies.

The IFAC's main target is to achieve a globally accepted level of audit quality. It is a non-profit, non-governmental, and non-political body. The IFAC mission is "to strengthen the worldwide accountancy profession and contribute to the development of strong international economies by establishing and promoting adherence to high-quality professional standards, furthering the international convergence of such standards and speaking out on public interest issues where the profession's expertise is most relevant." On the other hand, the role of the standards development and continuous improvement is usually handled by the International Federation of Accounts (IFAC). The IFAC, through the International Auditing Practices Committee (IAPC), issues International Standards of Auditing (ISAs) and International Auditing Practice Statements (IAPS) for the guidance of worldwide professions. ISAs are standards and are authoritative, while IAPS only provide guidance and are not authoritative. Most of the worldwide local professional bodies are members of the IFAC. IFAC has no direct obligatory power on auditors; however, its local and national members' professional bodies have obligatory powers on their member auditors. Any audit that uses International Standards of Auditing must be associated with using the IFAC Code of Ethics that requires auditors to have special characteristics, such as integrity, objectivity, professional competence, due care, confidentiality, professional behavior, professional skepticism, and independency.

Since the Asian financial crisis, international institutions, such as International Auditing and Assurance Standards Board (IAASB), International Federation of Accountants (IFAC), and International Accounting Standards Committee Foundation (IASCF) started to reform their published standards. By 2000, these institutions had issued 12 key standards that support the IFRS and International Standards of Auditing (ISAs) (**FSF, 2008**).

## 6.2 Audit Firms/Private Practicing Organizations

Audit firms usually face many different pressures. They are required to maintain their independence and objectivity during all audit phases, while they are under the influence of the clients' payments fees and market competition. These pressures affect the overall audit parties, starting by the audit firms and ending with the audit teams (**IFAC, 2003**). In general, audit firms are contracted parties without any direct fiduciary relation to the clients and to the clients' stockholder. They are only required to act professionally with proper due care, and not commit negligence or fraud (**Cunningham, 2004**).

Audit practicing by default requires a high degree of judgment. Audit staff should have proper technical knowledge with analytical skills. Also, the staff has to obtain advice from higher-experienced colleagues regarding interpretation of accounting standards and different audit techniques (**IFAC, 2003**). The audit firm's size is always related to its reputation — the bigger the size the more valuable the reputation and the stronger the incentives to perform high-quality audits (**DeAngelo, 1981**). Recently, a number of audit firms, including some of the internationally well-known firms, proceeded to merge to transform their activities into multi-specialty organizations with numerous services (**Hoitash et al., 2005**).

In real practice, there are only four international accounting firms that dominate the audit industry by controlling more than 60% of the U.S. market without any significant competition. The **United States General Accounting Office (2003)** study found that the companies, for which the Big Four audit firms provide services, represent an outstanding 99% of all public company sales. The report also found that the Big Four firms are auditing all companies with annual sales of \$5 billion or more. Regarding companies with sales size between \$250 million and \$5 billion, only 3% are not audited by the Big Four audit firms. The Big Four audit firms controlled the global market for audit services because of their share size. These firms were viewed as having the scales, technical expertise, and reputational incentives to uncover and expose most financial reporting irregularities. As a result of this monopoly, there is an imbalance in the relationship between the Big Four

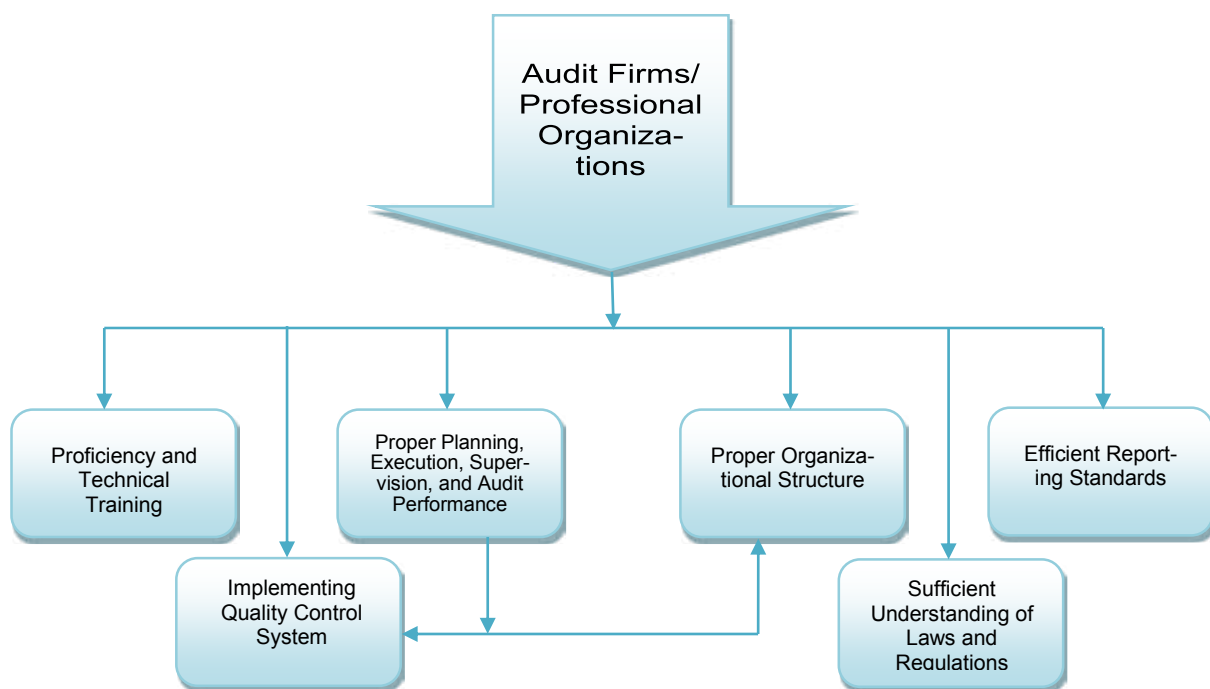


audit firms and their large clients, as clients essentially have nowhere else to turn other than the Big Four (**Shapiro, 2011**).

For the purpose of this study, Figure 6 presents the following proposed Audit Firms' environmental variables:

- Proficiency and Technical Training;
- Proper Planning, Execution, Supervision, and Audit Performance;
- Proper Organizational Structure;
- Efficient Reporting Standards;
- Implementing Quality Control System; and
- Sufficient Understanding of Laws and Regulations.

**Figure 6: Audit Firms' Environmental Variables**



**Source: Researcher**

Due to the complex economic global structure, audit firms' roles in public policy, economy, and financial markets have been significantly increased. Therefore, there are many worldwide changes in the applied practice laws and regulations, including the audit firms' practice governing rules. Audit firms are an important environmental variable that are closely associated with all other audit-practice environmental constructs. In the next section, we will discuss the key factors that affect audit firms' performance, and their connection with the other audit-practice environment variables.

### **6.2.1 Audit Firms' Performance and Efficiency**

Audit firms' performance is usually affected by the strength of a culture's core values, and the stability of internal and external environments. The degree of interrelation between functioning variables will be different in volatile environments. Management efficiency and quick responses determine the organization's capacity in controlling and influencing environmental changes (**Jones, 2007**). Given legal penalties threats and shareholder lawsuits, many researchers assumed that audit firms have valid reasons to report their clients' accounting and financial breaches. For that reason, audit firms, specifically big- and medium-sized ones, established control systems that counteract any potential threats of non-independency. These self-regulating systems enable audit firms to preserve their reputations and avoid any kind of legal charges (**Moore et al., 2005**). Researchers considered reputation as the most valuable intangible asset of audit firms, as it allows them to receive a reasonable premium fee against their services. Also, most audit firms' clients use the firms' reputation as a proxy variable to measure the expected service quality, which is hard to observe directly (**Getzen, 1984**). Any professional audit firm knows well that reputation is costly to gain and can easily be destroyed by not fulfilling market expectations (**Barzel, 1982**). Despite that academic researchers agreed on reputation importance, the last ten years witnessed many cases of audit firms' reputation being destroyed. Therefore, many researchers recommend the necessity of changing audit firms' legal structure, and most of the recent academic researchers suggested that evolved audit firms as unlimited partnerships will maximize the amount of assets

available as collateral bond for stakeholders. Accordingly, it will encourage mutual monitoring among auditors, as any audit firm can lose everything in a negligence lawsuit (**Fama & Jensen, 1983**). In general, assurance quality control, and audit firms' wide control procedures are required for any audit engagement, with a different implementation strategy based on the firm size and engagement type.

The auditors' compliance with professional ethical standards, independency, capabilities, and competences are the most important corners of quality controls that should be followed regardless of the characteristics of the audit firm.

## **6.2.2 Audit Firms' Size and Internal Ethical Values**

### **6.2.2.1. Audit Firm Size**

Audit firm size is often an indicator of proposed services quality, variety, cost, and type of clients. There is a high degree of positive correlation between these variables. Generally, big-size audit firms provide higher-quality services than small- and medium-size ones.

Big-size audit firms usually emphasize industry specialization in their audit practices (**Arens et al., 2005**). Also, they have more qualified staff and specialized human resources, thus they are better than smaller audit firms in screening and dealing with significant issues in financial statements (**Francis & Yu, 2009**). Moreover, they are able to provide information advice and support of complex matters (**IFAC, 2003**).

The audit firm size plays an important role in managing clients' relationships, and affects firm resistance to clients' pressures that may impair independency (**Moore et al., 2005**). It is assumed that big audit firms have to provide high-quality services, and comply with applicable international auditing standards to be able to compete with other local and international firms (**Abd-Elsalam & Weetman, 2003**).

From another point of view, small-size audit firms' services are more personalized than those of large firms. Small business managers frequently put more confidants in small audit firms, ask them for personal advice, and usually prefer to consult with the same person on many problems to pay low costs. These types of characterized services cannot be provided by big audit firms due to their high labor turnover rates and high cost of services (**Maijor & Meuwissen, 1993**). Therefore, we may be able to conclude that small audit firms can be more suited to meet the needs of small businesses, while big audit firms are more capable to add value through audit detecting, and reveal managements' errors or irregularities in financial reporting.

Despite all of that, we may be able to reduce the quality gap associated with a firm's size through developing of a proper audit environment, and imposing practicing standards that unify the types and levels of services provided by all sizes of local audit firms (**Johnson & Lys, 1990**).

#### **6.2.2.2**      *Audit Firm Internal Ethical Values*

**Schermerhorn (2010)** points out that the community culture context is the fundamental function in setting up ethical behavior. Recently there is a global focus on the importance of ethics universalism, which is based on the fact that ethical standards should be treated as absolute values and should be followed across all different cultures. This argument supports the importance of imperialistic accounting and auditing professional ethical standards to overcome the profession's ethical dilemma. Ethical standards usually create a gray decision area that may lead the person to end up with ethical valuation. The ethical lapses are more likely to occur gradually than rapidly (**Moore et al., 2005**). Furthermore, long term and close relationships with the audited clients may impair and affect audit firms' ethical values and professional skepticism (**Cunningham, 2004**).

Audit Firm Internal ethical values can be enhanced if the firm can complete assignments on time, within the estimated budget, with proper communications, and

efficiently achieve audit objectives. Audit firms' ethical values require real initiative commitments from firms' management to identify strategic and innovative ideas that support unconventional solutions and decision-making (**CICA, 2005**).

### **6.2.3 Audit Firm General Internal Regulations**

There is a strong positive correlation between organizational strong cultures and strong performance. Typically, environmental changes require modifications in organizational culture and routine. On the other hand, effective cultures reduce the organization's environment heterogeneity, enhance internal reliability, and lead to reliable performance through improving organizational control competencies. In general, audit organizations need more learning experience to react within volatile environments and changing situations (**Kotter & Heskett, 1992**).

Audit firms are required to periodically review and measure their risk levels in order to place proper safeguards and protect public interests. This approach helps in identifying any changes in the structures of variables that construct the audit environment (**Pendergast, 2005**). As a result, management of big audit firms requires a strong managerial board of partners to oversee the firm's engagements, coordinate its operating units, prepare planning strategy, and manage the firm's human resources. In practice, audit firms' partners are more close to the engagements and are able to make more practical decisions. Therefore, decisions related to accepting new clients, or rejecting current clients, must be decentralized to individual partners, while decisions' control rights are assigned to the firms' chairman (**Van Lent, 1999**).

The following is a summary of internal self-managing regulations that are mainly followed by big-size audit firms: (**CICA, 2005**):

- Identify firm's mission statement, strategic goals, and setting of personal goals that are consistent with the firms' goals;
- Complete assigned work as planned, suggest actions required for engage-

ment, improve efficiency, continuously assess performance, and update development plan;

- Periodically evaluate the firm's performance, market position, and related responsibilities;
- Evaluate each assignment contribution to the staff and the overall firm activities, and propose ideas that can be used to increase staff professional development;
- Complete assignments based on proper due care, high-quality standards, and most recent audit and accounting techniques;
- Rely on others' works only after establishing a reasonable basis for reliance;
- Accept and perform engagements, which present the firm's competencies; and
- Recognize the firm's competence limits, and seek other expertise involvement when necessary to complete tasks successfully.

These internal self-managing regulations can also be applied by both medium- and small-size firms, which will help in improving the overall audit-practicing environment.

### **6.2.3.1 *Audit Firms Internal Quality Regulations***

The impact of auditor reputation on audit quality always increases when there are market concerns about financial statements accuracy. Accordingly, financial statements' users request auditors' accreditation, which may adversely impact the audit firm's value if the auditor has low-quality measures (**Krishnamurthy et al., 2006**). Any auditor with a tarnished reputation will not be able to provide investors with sufficient assurance about financial information, which will increase audit's failure probability, and increase the auditor's litigation risk. In recent years, most of the audit firms developed a risk management portfolio approach to centralize screening of new and existing clients' risks. This approach may lead to different levels of quality between each audit assignment, based on the different assumed level of risk for each client (**Palmrose, 1988**).

Small- and medium-size audit firms, with a limited number of partners, are managed horizontally with equal rights for each partner. Their quality-control strategy will be more effective if focused on the engagement of quality control. However, in big audit firms, with a hierarchy that has many partners and centralized management, the quality-control focus will be based on two levels, the firm level that sets up the firm's quality policy, and engagement partners' level that controls the audit assignments' quality.

### **6.2.3.2 Audit Firm Staff Regulations**

The audit practice's human capital represents the main asset to provide audit services, which reflect the importance of investing in their development, training, motivation, and compensation. A single auditor deviated from the agreed service standards may hurt the firm's reputation.

Audit staff has to complete many processes during the different audit phases, including quality maintaining and soliciting of new clients. Therefore, auditors' specialization represents the most important factors that affect the future success of any audit firms. It typically affects the audit service pricing, and the audit quality dimensions.

Both rewarding and performance measuring can be used to motivate audit staff, and push them to achieve the firm's goals. Typically, audit firms' hierarchy consists of five levels: trainee, senior auditor, manager, senior manager, and partner. Any employee has to obtain certain levels of proficiency in audit and consultancy core competencies in order to be promoted. Also, audit staff must be able to operate independently as either auditors or management consultants, as they should obtain the necessary general professional skills (**Van Lent, 1999**). Audit firms need to follow proper personal methods that are based on recruiting proper staff, training them, and continuously evaluating their performance through on-the-job orientation, training, guidance, coaching, and supervision (**CICA, 2005**).

### **6.2.4 Governmental Regulatory Bodies and Laws**

Financial information presented by the companies always has a strong effect on the country's overall economy. The recent developments in corporate finance,

economy, and law increased researches focus on the importance of legal and corporate governance rules (**Hope, 2003**). On the other hand, audit function plays an important role in maintaining the society's welfare stability. **Porter et al. (2005)** point out that the audit is always a dynamic function rather than a static one, which means it should always change to suit society's expectations based on the surrounding economic, political, and sociological environment.

Regulations, laws, and rules are the most important environmental external drivers that affect companies' and audit firms' behaviors. Legislation is not a substitute for the presence of ethical standards as the underlying of these laws should always be a set of moral values. The building of a real ethical system requires integrated efforts, on the level of the professional practicing environment, to formulate an overall strategy. On the other hand, regulations refer to the creation of rules and subsequent implementation, which hinders and constrains the person's behavior or the group of people being regulated.

Typically, it will be more convenient if all auditing public-interest activities are constructed in clear and comprehensive standards. These standards, whether carried out by professional bodies or regulators, will provide guidance to all related parties and allow other parties to assess the performance of professional bodies and regulators (**Moore et al., 2005**).

The two most important sources of creative accounting inspiration are either flexibility or lack of regulation. Therefore, during the last decade, audit practice was subject to extensive reforms in many countries. The legal and other institutional characteristics of any country are influencing the demand for high-quality accounting information. Moreover, they affect the auditor's litigation risk and remunerations (**Largay, 2002**).

**Moore et al. (2006)** raise the issue of practicing environmental corruption. They point out that the practicing system has been institutionally corrupted starting from the auditors' mind, across the practicing structure, legalization, and the political process that regulates the profession's reforms. For that reason, any regulatory reforms should be combined with a sufficient information environment, and skilled



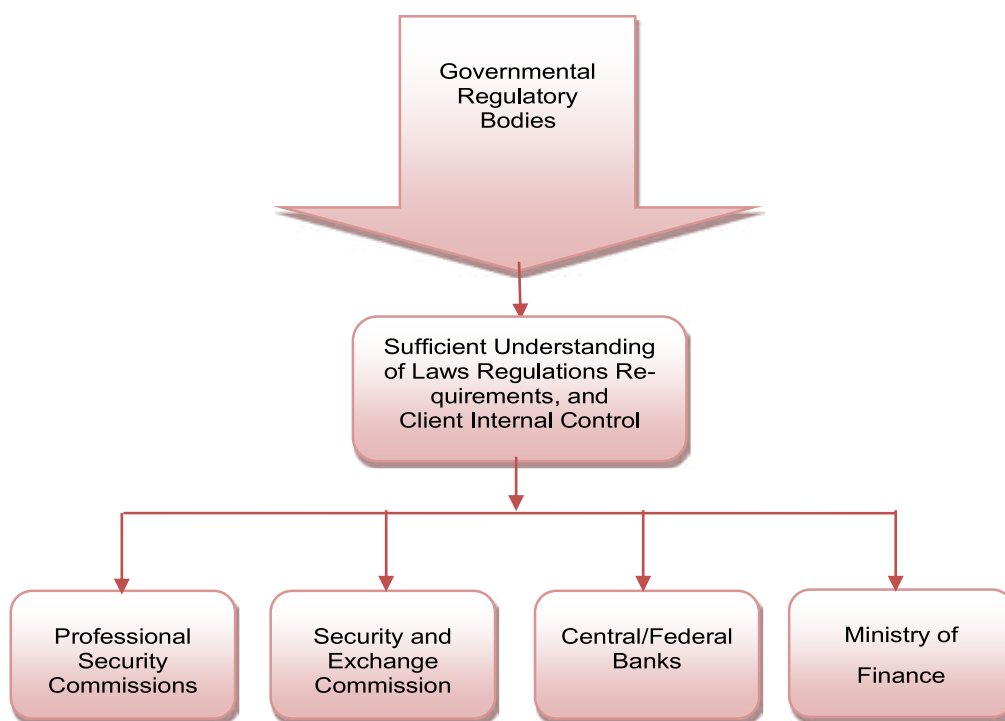
independent operating officers with low levels of corruption (**Caprio, 2009**).

Furthermore, **Rajan and Zingales (2003)** point out there is an important effect of legal and regulatory environment on structuring the auditors' performance. Accordingly, one of the recent changes in audit-practicing regulations was the focus on auditors and practicing regulatory bodies' performances. Typically, governmental organizations play an important role in reconstitution of the practicing regulatory bodies, in addition to their role in setting up auditors' accountability standards, and indirect developing and improving of auditing standards and professions' regulations (**Australian Accounting Research Foundation, 2002**).

As per the latest IFAC researches, most of the developed countries' licensing bodies and regulating accounting associations were created through the initiations of local professional accountants. These associations often sponsored legislation to set up the minimum requirements to designate individuals as professional public accountants. The IFAC raised the expectance of negative consequences when public practicing regulators lack skills or required resources to fulfill their roles, whether it was professional bodies that perform self-regulatory functions or governmental organizations. IFAC concluded that this situation may lead to defining the regulator's role in a narrow way; moreover, their governing rules and authorities will be ineffective, and will be subject to political pressures to do too little or too much (**IFAC, 2003**).

Figure 7 proposes the governmental regulatory bodies (governmental organizations) and other related entities that mainly affect the audit-practicing environment:

- Ministry of Finance;
- Professional Security Commissions;
- Central/Federal Banks; and
- Security and Exchange Commission.

**Figure 7: Governmental Regulatory Bodies/Organizations**

**Source: Researcher**

During the last two decades, there was a worldwide trend of deregulation and privatization, which decreased the levels and types of services provided by government units. However, recent shifts in global economic and social systems generated a high demand for independent public accounting, and encouraged many researchers to define the profession's dominance as an essential function to secure and maintain control over economic performance, political activities, and social intellectual spheres. This definition is in congruence with the practice profession's required society legitimate values and respects, which increased foreign investors' trust on audit-practice-provided services. Therefore, governments in developed countries reduced their intervention in public accounting practices, and focused on the reforms

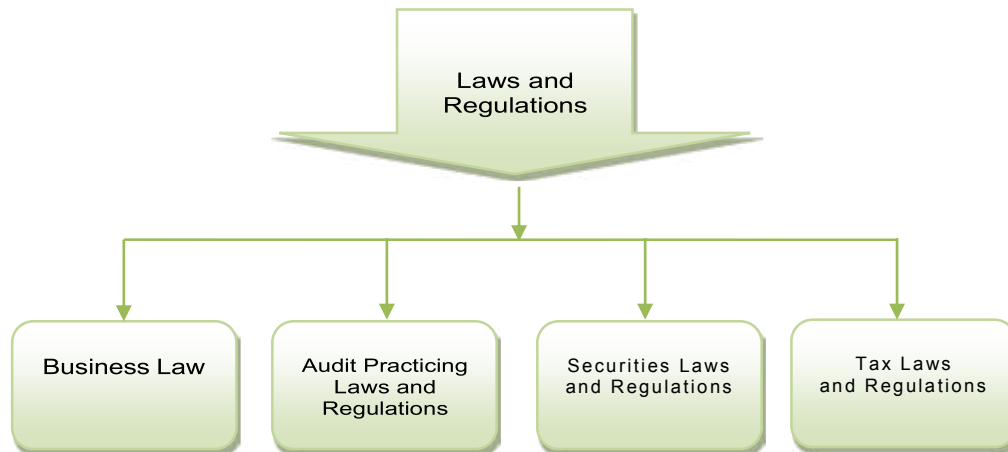
efforts of audit regulatory bodies, audit firm functions, and practicing administration. Also, governments' recent role starts to focus more on dealing with quality control over practicing through establishing of provincial committees for practice inspections.

On the other hand, standard setters and government regulators tried to investigate the reasons beyond the recent financial scandals. They attempt to restore the public audit integrity and to prevent any investors through a bundle of new laws and regulations that prohibit auditors of public companies from offering consulting services to their audited clients, and impose those auditors to report directly to the audit committee, and moreover to disclose the non-audit fees gained from their clients **(Baker, 2002)**.

Improving auditors' objectivity, and encouraging audit firms to increase their independency, has emphasized public policy makers to focus on mixing strict legal regimes with proportionate damage rules **(Moore et al., 2005)**. This mixed legal approach allows investors to sue auditors and recover their investment losses that may result from auditors' negligence. Thus auditors provide an implicit undertaking to investors against their investment losses **(Krishnamurthy et al., 2006)**.

In general, government regulating of audit practice requires an exceptional consideration of many other laws and regulations. Figure 8 proposes the main laws and regulations that may have an effect on audit practice environment:

- Business Law;
- Audit Practicing Laws and Regulations;
- Securities Laws and Regulations; and
- Tax Laws and Regulations.

**Figure 8: Laws and Regulations**

**Source: Researcher**

### 6.2.5 Auditors' Characteristics

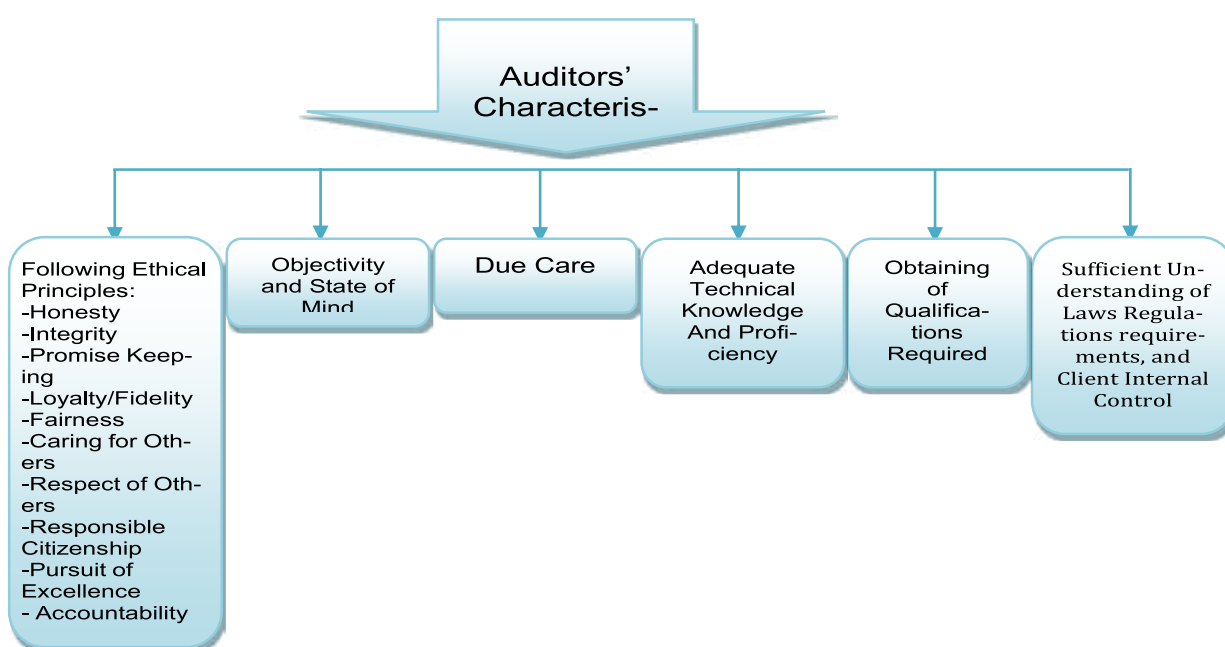
Despite the importance of the ethical role in the audit community, and the high investors' costs resulting from the ethics collapse, auditing studies that link both the auditors' independence and their ethical propensity are rare (Yu, 2004). Low et al. (2008) point out that auditors' integrity and morality have a high impact on the organization's ethical values, thus strengthening audit-practicing standards will reduce any future financial failures.

Auditor characteristic is one of the most important variables that may affect the audit environment. Auditors are the main tool of practice performance. They set up the firms' policies, following practice laws and implementing the regulatory bodies' instructions. Auditors' professional opinions are directly affected by their characteristics, which are mainly influenced by their ethical values, such as independencies and competency (Arens et al. 2005). Figure 9 proposes the most important ethical values that can directly structure auditors' characteristics:

- Following of Ethical Principles, "Honesty, Integrity, Promise Keeping, Loyalty/Fidelity, Fairness, Caring for Others, Respect of Others, Citizenship Responsibility, Pursuit of Excellence, and Accountability";
- Objectivity and State of Mind;

- Due Care;
- Adequate Technical Knowledge and Proficiency;
- Obtaining of Required Qualifications;
- Sufficient Understanding of Laws and Regulations' requirements; and
- Sufficient Understanding of Clients' Internal Controls.

**Figure 9: Auditors' Characteristics and Ethical Values**



**Source: Researcher**

### 6.2.5.1 Auditors' Ethical Values

Human factors played a critical role in the success of any self-directed process team. The self-direction concept only works when the practicing team understands the objectives and commits to achieving them. Therefore, all team members must work together to formulate tasks and commit themselves to achieve them.

On the other hand, ethics is a personal issue that involves a commitment to the common values, and can affect individual decisions and self-direction. Ethical values may be enhanced by applying the values of integrity and transparency that

encourage auditors to put the public interests ahead of both personal interests and clients' interests (**Reiter, 1997**). The ethical responsibilities go beyond the letter of the law, as auditors should always resist any attempts of promise breaking or self-dealing engagement. This resistance is called the trustworthiness that symbolizes the central virtue of the accounting profession.

The potential influence of personal values on ethical decisions and behavior has been studied early in both social psychology and organizational behavior researches. In general, values are closely relative to enduring beliefs, and totally differentiated from other similar concepts such as attitudes. Recently, the affect of personal values on ethical judgments has been academically integrated to the organization's ethical decision-making models (**Shafer et al., 2001**).

**Mark (1995)** points out that professional business development should focus on building individuals' morals to qualify them to wisely identify and articulate the ethics of any faced situation. Moreover, individuals' morals enable them to explore politically acceptable alternative solutions.

Applying ethical behavior helps auditors to achieve long-term profits, while respecting their integrity, personal satisfaction, and honesty. Also, enhancing auditors' ethical traits will increase audited clients' loyalty, confidence, and satisfaction (**Duska et al., 2011**).

The main target of any ethical system is to increase the transparency and credibility of audit practice organizations through implanting the moral dimension in their management actions and decisions (**Virovere & Rihma, 1997**). Typically, ethical behavior is the glue that holds any society together, which is necessary for any society to function properly. As a result, most of the worldwide accounting and auditing associations have defined different moral codes and values that at least include, "Honesty, Integrity, Loyalty, Fidelity, Fairness, Respect for Others, Pursuit of Excellence, and Accountability"; these codes are mainly targeted to achieve integrity, and avoid any possible conflict of interests through putting into practice the

following steps: **(CICA, 2005)**.

- Achieve strong member loyalty, and enhance market appreciation of the professions;
- Increase public and member understanding of the conflict of interests' consequences, and suggest methods to avoid conflicted situations;
- Subscribe the opinion with the government organizations regarding any proposed development of national tax system and corporate acts;
- Encourage professional members to perform their engagements based on the highest-quality standards;
- Encourage professional members to demonstrate a leading advocacy role with national, international governments, and regulators.

#### **6.2.5.2 Auditors' Independency**

Not all legal behaviors are considered ethical. The code of moral and underlying values always guides a person to identify what is good and right (**Schermerhorn, 2010**). However, it is still difficult for auditors to maintain their skepticism while simultaneously satisfying their clients (**McCracken et al., 2008**). Due to the auditors' independency and conflict of interest, it became clear in many recent financial scandals that there is an essential need to revamp the audit industry (**Agrawal & Chadha, 2005**).

Auditor independency is the cornerstone of audit ethics. It is the main element for investors' financial statement confidence. Currently, there is a strong need to harmonize worldwide independency standards in order to properly respond to the business environment changes (**Pendergast, 2005**), particularly, if we consider the regulators' wide debate regarding the relationship between auditors' independence, and the quality of their performed engagements (**Hoitash et al., 2005**). Most of the current academic discussions about auditors' independence have focused on the provisions of non-audit services executed by audit firms to their audited cli-

ents. However, in practice there is no evidence that supports the hypothesis of economic bonds between the auditor and client that may compromise auditor independence and disclosure quality (**Ashbaugh et al., 2003**). In practice, auditors may be under pressure to provide their clients with additional non-audit services without increasing the fees, which may negatively impact the quality of provided services. Accordingly, IFAC recommended the necessity of additional control safeguards on any auditor-provided non-audit services to maintain auditors' independence and objectivity (**IFAC, 2003**). The effective safeguard controls approach is measuring the total non-audit professional fees, rather than measuring the non-audit professional fees ratio to the total collected fees. This approach is better in capturing the economic relationship between the audit firm and its clients. In the wake of both Enron and Arthur Andersen's failure, the U.S.'s extensive legislation focused on stopping public accounting firms from rendering non-audit-related services to their current audit clients. It also emphasizes auditors to disclose the total collected fees for the last two fiscal years classified as follows (**Hoitash et al., 2005**):

- (a) Audit Fees;
- (b) Audit-Related Fees; and
- (c) Tax Fees.

In general, professional ethics standards are evolutionary and must be changed overtime to reflect the social, legal, economic, political, and cultural norms of society (**Australian Accounting Research Foundation, 2002**).

### **6.2.5.3 Auditors' Competency**

Both individual and institutional integrity are essential to rebuild confidence in financial reporting. IFAC recommended that each audit firm should develop and implement a corporate code of conduct. IFAC concluded that auditors' poor integrity was the main contributor to the recent financial scandals (**IFAC, 2003**). In general, auditors' competency, knowledge, skills, and performance are actively contributing in enhancing the audited entity's performance. **Pandit (1999)** concludes that



auditors' competence is positively correlated to both clients' satisfactions and stakeholders' benefits. Also, **Behn et al. (1999)** argue that auditors' skepticism is negatively correlated to the auditors' client satisfaction relationship. The assessment of auditors' competencies unusually takes place on a continuous basis over their practicing life. Most of the auditors' knowledge and skills are gained during their formal education and on-site practice. Therefore, auditors should present competencies in the four generic tasks of audit planning, evidence gathering, evidence evaluation, and decision-making (**ICAA, 2004**).

The idea for this research came from the fact that the current audit practice environment in Egypt has the following weakness factors:

- Gap between Egyptian practicing law and modern practicing requirements;
- Educational quality suffers from the continuous absence of education rules, which increased practitioners' knowledge gap;
- Weakness of practitioners' registration system;
- No imposed laws to encourage implementing neither IFAC nor IFRS recent standards;
- Egyptian professional ethical standards should be updated;
- Egyptian political system phased all necessary legislative reforms;
- Current laws and regulations formed unethical, inefficient practicing system; and
- Egyptian auditor's independence is strongly affected.

These drawbacks attracted the attention to the necessity of academically researching the main following hypotheses:

- 1. Updating of practicing law will partially participate in developing audit environment;

- 2. Increasing of the efficiency of audit-practicing environment required structure of all environment fundamental factors in the same time but not with the same degree of importance;
- 3. Increasing of audit-practicing firms' quality-control procedures will increase the efficiency of audit practicing environment more rapidly than other fundamental factors;
- 4. International environment fundamental factors will have a positive effect in practicing environment reform; and
- 5. The primary factors that are expected to have the most important effect in the practicing environment reform will be the governmental regulatory bodies and non-governmental associations.

The main results of the survey parts that support the research hypotheses have been analyzed by SPSS analyses software. The results are presented in the following chapter.

**Chapter 7**  
**Empirical Research**

## **Chapter 7: Empirical Research**

Increasing the quality of governmental, non-governmental associations, and audit firms cannot be achieved without considering others' environmental factors that may affect their performance. Our research has been built based on studying the pre-described variables that surround both the local and international audit-practicing environment.

In order to empirically examine our hypotheses, we defined the main variables that may have effects on the audit-practicing environment performance and efficiency. A detailed survey questionnaire was designed, comprised of 51 questions, and includes five parts, each of which includes detailed questions that measure different variable implications and their relationship with the Egyptian local audit-practicing environment. These questions are measured through auditors, selected samples, and responses to agreement score of certain statements that discuss the variables effects.

## 7.1 Details of Survey Questions

We used structured survey tool to minimize the variations between interviewers, the qualifications and professionalism level questions were asked first, followed by questions about expected weighted average and importance of the predetermined questionnaire five main parts, and their magnitude on audit practicing environment. Following are details of survey questions:

### 7.1.1 Part (1): The effect of non-governmental professional associations on the auditing environment

- 1- The effect of non-governmental professional associations is one of the factors influencing the auditing environment.
- 2- The membership of professional associations must be a requirement for obtaining the practicing license.
- 3- Do you believe in the role of professional associations in developing the auditing profession?
- 4- Do you believe in the necessity of activating the professional associations' role to be the main supervisory authority controlling the application of professional requirements?
- 5- Do you think that the supervision of the role and performance of professional associations must be carried out by a governmental authority?
- 6- Does the Profession Practicing Law need to be ruled by the powers and responsibilities of the professional associations?
- 7- The dependency of the professional associations to the governmental legislative authority increases the efficiency of its role affecting the auditing environment.
- 8- The professional associations have more effective role on the auditing process than the government authorities regulating the companies' operations.
- 9- Dealing with the international professional authorities "IAS Board, IFAC"

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should be carried out through the professional associations not the governmental organizations related to auditing.

- 10- The standardization of dealing with the professional associations as a main authority regulating auditing offices and auditors will increase the efficiency and performance of the auditing practicing.

### **7.1.2 Part (2): The effect of the professional organizations practicing on the auditing environment**

- 1- The mutual understanding between the customers and the professional organizations on the provided services helps in improving the performance of auditing general environment.
- 2- The availability of a system for evaluating the efficiency and quality of the relation with the customer has a limited effect on the auditing general environment.
- 3- The planning for the control arrangements of applying the professional quality in a way that meets the organizational requirements and technical standards helps in improving the performance of auditing general environment.
- 4- The auditor's awareness of the customer's work field and activities has a limited effect on the audit practicing environment.
- 5- Keeping the auditors up to date with the changes of the professional requirements, (accounting standards, independency, objectivity, policies and procedures), helps to activate the auditing general environment.
- 6- The availability of internal rules at the professional organizations guarantying the regular change of auditors helps to improve the audit practicing environment.
- 7- The organizations' use of an effective mechanism to face the failure in the application of quality procedures and policies helps to improve the auditing general environment.
- 8- Do you think the professional organizations working in the auditing field are one of the factors that influencing the auditing general environment?

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**7.1.3 Part (3): The effect of the governmental authorities and laws on the auditing general environment****(A) General questions:**

- 1- Do you think the role of the governmental authorities, laws, financial and professional regulations are one of the factors affecting the audit practicing environment.
- 2- Do you think that the amendment of the professional laws and regulations has less effect on the audit practicing environment than the professional associations' role?
- 3- Do you think that the amendment of the laws regulating the companies' operations through clearer definition of the Board role and practicing morals will positively affect the audit-practicing environment?
- 4- Do you think the selection; appointment and termination of the services of auditor by the General Assembly through the company's internal auditing committee will help increase the efficiency of the auditing profession environment through the auditor's independency?
- 5- Do you think that the non-governmental authorities related to the auditing profession must have a role in formulating the laws affecting the auditing profession environment, (companies' laws, commercial laws, stock market laws, and auditing practicing laws), which helps increase the efficiency of the laws and improves the audit practicing environment.
- 6- The role of setting the accounting standards and the supervision of the professional offices should be carried out through the governmental authorities related to auditing.
- 7- The mutual cooperation between the governmental authorities and professional associations in organizing the auditing profession will improve the performance of the auditing environment.

**(B) Questions on the law regulating the practice of auditing profession:**

- 1- The inclusion of rules determining the auditor's fees in the auditing practice law will positively affect the audit practicing environment.

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- 2- The inclusion of restrictions on the financial relation between the auditor and the customer in the auditing practice law will positively affect the audit practicing environment.
  - 3- The inclusion of the auditor's rights and duties as per the international standards in the auditing practice law will positively affect the audit practicing environment.
  - 4- The modification of all types of services provided by audit offices in the auditing practice law will positively affect the audit-practicing environment.
  - 5- The amendment of the auditing practice law to include only the services related to obligatory annual auditing will positively affect the audit-practicing environment.
  - 6- The inclusion of the conditions and rules of the auditors' continuing learning in the auditing practice law will positively affect the audit practicing environment.
  - 7- The inclusion of the condition of passing a test after completing the professional program as a requirement for obtaining the license in the auditing practice law will positively affect the audit practicing environment.
  - 8- The inclusion of the condition of having a relative previous experience for obtaining the license in the auditing practice law will positively affect the audit-practicing environment.
  - 9- Allowing the non-certified auditors to own 49% of the auditing offices will positively affect the audit-practicing environment.
  - 10- The amendment of the profession laws to include the necessity of applying the international auditing standards will positively affect the audit practicing environment,
  - 11- The inclusion of Code of ethics in the auditing practice law will positively affect the audit-practicing environment.
  - 12- The inclusion of the powers and responsibilities of the Professional Associations and their control on the auditing offices and members in the auditing practice law will have a limited effect on the auditing profession environment.



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- 13- The inclusion of the entities authorized to deal with international professional auditing and accounting associations in the auditing practice law will positively affect the audit practicing environment.
  - 14- The inclusion of a mechanism to regulate the relations between the governmental and non-governmental authorities ruling this profession and the auditing offices and auditors in the auditing practice law will positively affect the audit practicing environment.

**7.1.4 Part (4): The effect of the auditors' qualification on the audit practicing environment.**

- 1- Do you think that the application of continuing vocational education will be more effective if carried out through obligatory instructions from the professional associations regulating the auditing profession?
- 2- Do you think that the professionalism of the auditor is one of the factors affecting the audit practicing environment?
- 3- Assigning the professional associations to supervise the auditor's commitment to the continuing education requirements will have more effect on the audit practicing environment, rather than assigning the governmental authorities to this task.
- 4- Determining the auditor's annual duties should be based on the vocational training previously received.
- 5- The commitment to Code of Ethics plays a more effective role in improving the audit practicing environment, than the laws regulating profession practice and companies operations.

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**7.1.5 Part (5): The effect of the interested parties on the audit practicing environment.**

- 1- Do you think that the interested parties and beneficiaries, (Stock companies managements, banks, governmental and supervisory authorities), are one of the factors affecting the audit practicing environment.
- 2- Do you think that the main interest of the beneficiaries is to obtain the financial statements, information summary and the financial policies rather than obtaining efficient recommendations or realizing the scope of work and procedures applied by the professional authorities?
- 3- Do you think that the companies' managements growing awareness of their social responsibilities help increasing the performance and efficiency of the audit practicing environment?
- 4- The meeting of the beneficiaries' unusual requirements is one of the auditing priorities.
- 5- The beneficiaries' continuing interest in following up the auditing procedures provided by the professional authorities and the verification of these authorities' recommendations will help improving the audit practicing environment.
- 6- The management philosophy and operating way may affect the audit- practicing environment.
- 7- Obliging the commercial organizations by the governmental supervisory authorities to apply the code of ethics through the business ethics laws and the auditing committees' duties strongly affects the audit practicing environment.

All of the above mentioned questions have a respond categories ranged between strongly agree (1), to strongly not agree (5). Two general questions were constructed in shape of giving an average weight of effect and existence of the 5 parts that assumed to effect the audit environment.

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## 7.2 Sample Construction and Results

### 7.2.1 Sample Construction

Due to the importance of the study in reforming of the audit practicing environment, and audit law and regulations in Egypt, the survey was based on the highest level of professional auditors in Egypt that mainly represented in the fellows and members of The Egyptian Society of Accountants and Auditors (ESAA). Accordingly the questionnaire were mainly assumed to be distributed through interviews to all the fellows of Egyptian Society of Accountants and Auditors (ESAA); as representative of the most qualified and experienced category of audit professions.

The total sample is represented by the total population of fellows of Egyptian Society of accountants and Auditors, based on data collected from the National Institute of Accountants and Auditors the fellows total numbers was 234, based on 2008 available data. This number was taken as the target population for this study, out of which 105 fellows' auditors approved to share in the research. ESAA Fellows were contacted by telephone and letters to generate interests and obtain approval for interview. Due to the nature of accounting and auditing business filed, it talks a lot of time to fix interview appointments with the selected ESAA's fellows; however most of them asked to receive a copy of the questionnaire before approving on interview appointment. Some of ESAA contacted fellows refused to be interviewed; typically they gave reasons, such as they were too busy or they never participate in surveys.

Most of the interviews (103) have been conducted in auditors' offices while 2 interviews have been done during the international conference organized by the Syndicate of Accountants on the topic "How to Reform Auditing Environment" conducted in Egypt in February 2008 and attended by many Egyptian and Arab key professional accountants and auditors. The questionnaire is also distributed to all the conference attendants as a part of the conference tool kits.

About half of the interviews were conducted in 2 of the biggest audit firms in Egypt:

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- KPMG (Hazem Hassan); and
  - Price Water House.

As we previously mentioned, the number of questionnaires sent, and fellows targeted to be interviewed were 234, which represents 100% of ESAA Fellows published list during 2008. From this number only 105 fellows approve to cooperate, and interviewed, this sample size of 105 allowed for a confidence level of 95% and confidence interval of + 7.72%.

Study sample demographics included 105 leading auditors' members of ESAA, 23% of them had "CPA", 10% "CIA", 3% "ACCA", 2% "CA" while others had "CIPA, CMA, CFM, and CICA". Currently, 53% of the sample were "Employees in a private auditing office", 24% "Professional Firm Owners", 4% "Governmental Auditors" and 23% work in "others; as Financial Managers or University Professors".

Regarding the work field, 75% of the sample work in "auditing", 34% "general accounting", 29% "taxing", 6% "costing", 5% "insurance" and 8% "others; as training, consultancy, fidelity studies, financial management". 39% of the interviewed auditors evaluated their professional performance as "excellent", 55% "good", 5% "average" and 1% "bad".

The following Appendices give summary of sample respondents' allocation based on their:

- Personal Qualifications;
- Current job and; and
- Work filed.

**Professional Certification****Appendix (1)**

Sample size	105	
Base	105	
Sum	145	138%
CPA	24	23%
CIA	11	10%
CA	2	2%
ACCA	3	3%
Others	105	100%

**Current Job****Appendix (2)**

Sample size	105	
Base	105	
Sum	109	104%
Governmental	4	4%
Employee in a private auditing office	56	53%
Professional Firm Owner	25	24%
Others	24	23%

**Work Field****Appendix (3)**

Sample size	105	
Base	105	
Sum	164	156%
Insurance	5	5%
Taxing	30	29%
Costs	6	6%
General Accounting	36	34%
Auditing	79	75%
Others	8	8%

**7.2.2 Sample Results**

During analyzing the data our main focus was to determine the most agreed factors that may have effects on the efficiency of audit practicing environment, this has been done through the defining of agreement score per each question of the survey as presented below:

**The Effect of Non-governmental Professional Associations on the Auditing Environment**  
**Appendix (4)**

<i>First Part: The effect of non-governmental professional associations on the auditing environment</i>	<i>Agreement Score</i>	<i>Comment</i>
1- The effect of non-governmental professional associations is one of the factors influencing the auditing environment.	4.17	
2- The membership of professional associations must be a requirement for obtaining the practicing license.	4.14	
3- Do you believe in the role of professional associations in developing the auditing profession?	4.36	Most agreed with
4- Do you believe in the necessity of activating the professional associations' role to be the main supervisory authority controlling the application of professional requirements?	4.18	Third most agreed with
5- Do you think that the supervision of the role and performance of professional associations must be carried out by a governmental authority?	3.20	
6- Does the Profession Practicing Law need to be ruled by the powers and responsibilities of the professional associations?	4.03	
7- The dependency of the professional associations to the governmental legislative authority increases the efficiency of its role affecting the auditing environment.	3.74	
8- The professional associations have more effective role on the auditing process than the government authorities regulating the companies' operations.	3.52	
9- Dealing with the international professional authorities "IAS Board, IFAC" should be carried out through the professional associations not the governmental organizations related to auditing.	4.15	
10- The standardization of dealing with the professional associations as a main authority regulating auditing offices and auditors will increase the efficiency and performance of the auditing practicing.	4.30	Second most agreed with

**The Effect of the Professional Organizations Practicing Auditing on the Auditing Environment**  
**Appendix (5)**

<i><b>Second Part: The effect of the professional organizations practicing auditing on the auditing environment</b></i>	<i><b>Agreement Score</b></i>	<i><b>Comment</b></i>
1-The mutual understanding between the customers and the professional organizations on the provided services helps in improving the performance of auditing general environment.	4.60	Second most agreed with
2- The availability of a system for evaluating the efficiency and quality of the relation with the customer has a limited effect on the auditing general environment.	2.72	
3- The planning for the control arrangements of applying the professional quality in a way that meets the organizational requirements and technical standards helps improving the performance of auditing general environment.	4.23	
4- The auditor's awareness of the customer's work field and activities has a limited effect on the audit practicing environment.	2.11	
5- Keeping the auditors up to date with the changes of the professional requirements (accounting standards, independency, objectivity, policies and procedures) helps activate the auditing general environment.	4.69	Most agreed with
6- The availability of internal rules at the professional organizations guarantying the regular change of auditors helps improve the audit practicing environment.	4.09	
7- The organizations' use of an effective mechanism to face the failure in the application of quality procedures and policies helps improve the auditing general environment.	4.25	
8- Do you think the professional organizations working in the auditing field are some of the factors influencing the auditing general environment?	4.38	Third most agreed with

**The Effect of the Governmental Authorities and Laws on the Auditing General Environment**

**Appendix (6)**

<i>Third part: The effect of the governmental authorities and laws on the auditing general environment</i>	<i>Agreement Score</i>	<i>Comment</i>
<b>(A) General questions:</b>		
1- Do you think the role of the governmental authorities, laws, financial and professional regulations are one of the factors affecting the audit practicing environment.	4.10	Second most agreed with
2- Do you think that the amendment of the professional laws and regulations has less effect on the audit practicing environment, than the professional associations' role?	2.59	
3- Do you think that the amendment of the laws regulating the companies' operations through clearer definition of the Board role and practicing morals will positively affect the audit practicing environment?	4.04	
4- Do you think the selection, appointment and termination of the services of auditor by the General Assembly through the company's internal auditing committee will help increase the efficiency of the auditing profession environment through the auditor's independency?	3.99	
5- Do you think that the non-governmental authorities related to the auditing profession must have a role in formulating the laws affecting the auditing profession environment (companies' laws, commercial laws, stock market laws, and auditing practicing laws) which helps increase the efficiency of the laws and improves the audit practicing environment?	4.05	Third most agreed with
6- The role of setting the accounting standards and the supervision of the professional offices should be carried out through the governmental authorities related to auditing.	3.13	
7- The mutual cooperation between the governmental authorities and professional associations in organizing the auditing profession will help improve the performance of the auditing environment.	4.17	Most agreed with



**The Effect of the Governmental Authorities and Laws on the Auditing General Environment**

**Appendix (7)**

<i>Third part: The effect of the governmental authorities and laws on the auditing general environment</i>	<i>Agreement Score</i>	<i>Comment</i>
<b>(B) Questions on the law regulating the practice of auditing profession:</b>	Agreement Score	Comment
1- The inclusion of rules determining the auditor's fees in the auditing practice law will positively affect the audit practicing environment.	3.38	
2- The inclusion of restrictions on the financial relation between the auditor and the customer in the auditing practice law will positively affect the audit practicing environment.	3.55	
3- The inclusion of the auditor's rights and duties as per the international standards in the auditing practice law will positively affect the audit practicing environment.	4.16	
4- The modification of all types of services provided by auditing offices in the auditing practice law will positively affect the audit practicing environment.	3.71	
5- The amendment of the auditing practice law to include only the services related to obligatory annual auditing will positively affect the audit practicing environment.	2.90	
6- The inclusion of the conditions and rules of the auditors' continuing learning in the auditing practice law will positively affect the audit practicing environment.	4.35	Second most agreed with
7- The inclusion of the condition of passing a test after completing the professional program as a requirement for obtaining the license in the auditing practice law will positively affect the audit practicing environment.	4.37	Most agreed with
8- The inclusion of the condition of having a relative previous experience for obtaining the license in the auditing practice law will positively affect the audit practicing environment.	4.33	Third most agreed with
9- Allowing the non-certified auditors to own 49% of the auditing offices will positively affect the audit practicing environment.	2.42	
10- The amendment of the profession laws to include the necessity of applying the international auditing standards will positively affect the audit practicing environment.	4.25	

**The Effect of the Governmental Authorities and Laws on the Auditing General Environment**

**Appendix (8)**

<b><i>Third part: The effect of the governmental authorities and laws on the auditing general environment</i></b>	<b>Agreement Score</b>	<b>Comment</b>
11- The inclusion of Code of ethics in the auditing practice law will positively affect the audit practicing environment.	4.31	
12- The inclusion of the powers and responsibilities of the Professional Associations and their control on the auditing offices and members in the auditing practice law will have a limited effect on the auditing profession environment.	2.82	
13- The inclusion of the authorities authorized to deal with international professional auditing and accounting associations in the auditing practice law will positively affect the audit practicing environment.	4.04	
14- The inclusion of a mechanism to regulate the relations between the governmental and non-governmental authorities ruling this profession and the auditing offices and auditors in the auditing practice law will positively affect the audit practicing environment.	4.21	
<b><i>(c) Questions related to the laws regulating the companies' operations:</i></b>	<b>Agreement Score</b>	<b>Comment</b>
1- The inclusion of a condition that guaranties the auditor's independency in the laws regulating the companies' operations will positively affect the audit practicing environment.	4.53	Most agreed with
2- The inclusion of a condition that obliges the auditor to declare the amounts obtained from the customer for services provided other than the auditing in the laws regulating the companies' operations will positively affect the audit practicing environment.	3.81	
3- The inclusion of a mechanism that obliges the companies to change the auditor after a determined term (5 years for example) in the laws regulating the companies' operations will positively affect the audit practicing environment.	3.68	
4- The amendment of the laws regulating the companies' operations to include a condition obliging he companies to apply the international accounting standards will positively affect the audit practicing environment.	4.29	Third most agreed with
5- The amendment of the laws regulating the companies' operations to include a Code of ethics will positively affect the audit practicing environment.	4.34	Second most agreed with

**The Effect of the Auditors' Qualification on the Audit Practicing Environment**  
**Appendix (9)**

<b><i>Forth Part: The effect of the auditors' qualification on the audit practicing environment.</i></b>	<b><i>Agreement Score</i></b>	<b><i>Comment</i></b>
1- Do you think that the application of continuing vocational education will be more effective if carried out through obligatory instructions from the professional associations regulating the auditing profession?	4.17	Second most agreed with
2- Do you think that the professionalism of the auditor is one of the factors affecting the audit practicing environment?	4.35	Most agreed with
3- Assigning the professional associations to supervise the auditor's commitment to the continuing education requirements will have more effect on the audit practicing environment, rather than assigning the governmental authorities to this job.	3.89	
4- Determining the auditor's annual duties should be based on the vocational training previously received.	3.95	
5- The commitment to Code of Ethics plays a more effective role in improving the audit practicing environment, than the laws regulating profession practice and companies operations.	3.96	Third most agreed with

**The Effect of the Interested Parties on the Audit Practicing Environment  
Appendix (10)**

<b><i>Fifth Part: The effect of the interested parties on the audit practicing environment.</i></b>	Agreement Score	Comment
1- Do you think that the interested parties and Beneficiaries, (Stock companies managements, banks, governmental and supervisory authorities), are one of the factors affecting the audit practicing environment.	4.03	
2- Do you think that the main interest of the beneficiaries is to obtain the financial statements, information summary and the financial policies rather than obtaining efficient recommendations or realizing the scope of work and procedures applied by the professional authorities?	3.18	
3- Do you think that the companies' managements growing awareness of their social responsibilities help increasing the performance and efficiency of the audit practicing environment?	4.10	
4- The meeting of the beneficiaries' unusual requirements is one of the auditing priorities.	2.46	
5- The beneficiaries' continuing interest in following up the auditing procedures provided by the professional authorities and the verification of these authorities' Recommendations will help improving the audit practicing environment.	4.40	Most agreed with
6- The management philosophy and operating way may affect the audit practicing environment.	4.22	Second most agreed with
7- Obliging the commercial organizations by the governmental supervisory authorities to apply the code of ethics through the business ethics laws and the auditing committees' duties strongly affects the audit practicing environment.	4.21	Third most agreed with

**The summary of most agreed 1st, 2nd, and 3rd questions in each part is as follows:**

**The Effect of Non-governmental Professional Associations on the Auditing Environment**

**Appendix (11)**

<i><b>First Part: The effect of non-governmental professional associations on the auditing environment</b></i>	<i><b>Agreement Score</b></i>	<i><b>Comment</b></i>
3- Do you believe in the role of professional associations in developing the auditing profession?	4.36	Most agreed with
4- Do you believe in the necessity of activating the professional associations' role to be the main supervisory authority controlling the application of professional requirements?	4.18	Third most agreed with
10- The standardization of dealing with the professional associations as a main authority regulating auditing offices and auditors will increase the efficiency and performance of the auditing practicing.	4.30	Second most agreed with
<i><b>Second Part: The effect of the professional organizations practicing auditing on the auditing environment</b></i>	<i><b>Agreement Score</b></i>	<i><b>Comment</b></i>
1- The mutual understanding between the customers and the professional organizations on the provided services helps improving the performance of auditing general environment.	4.60	Second most agreed with
5- Keeping the auditors up to date with the changes of the professional requirements, (accounting standards, independency, objectivity, policies and procedures), helps activate the auditing general environment.	4.69	Most agreed with
8- Do you think the professional organizations working in the auditing field are some of the factors influencing the auditing general environment?	4.38	Third most agreed with
<i><b>Third part: The effect of the governmental authorities and laws on the auditing general environment</b></i>	<i><b>Agreement Score</b></i>	<i><b>Comment</b></i>
<i><b>(B) Questions on the law regulating the practice of auditing profession:</b></i>	<i><b>Agreement Score</b></i>	<i><b>Comment</b></i>
6- The inclusion of the conditions and rules of the auditors' continuing learning in the auditing practice law will positively affect the audit practicing environment.	4.35	Second most agreed with

7- The inclusion of the condition of passing a test after completing the professional program as a requirement for obtaining the license in the auditing practice law will positively affect the audit practicing environment.	4.37	Most agreed with
8- The inclusion of the condition of having a relative previous experience for obtaining the license in the auditing practice law will positively affect the audit practicing environment.	4.33	Third most agreed with
<b>(c) Questions related to the laws regulating the companies' operations:</b>		
1- The inclusion of a condition that guaranties the auditor's independency in the laws regulating the companies' operations will positively affect the audit practicing environment.	4.53	Most agreed with
4- The amendment of the laws regulating the companies' operations to include a condition obliging the companies to apply the international accounting standards will positively affect the audit practicing environment.	4.29	Third most agreed with
5- The amendment of the laws regulating the companies' operations to include a Code of ethics will positively affect the audit practicing environment.	4.34	Second most agreed with
<b><i>Forth Part: The effect of the auditors' qualification on the audit practicing environment.</i></b>	<b><i>Agreement Score</i></b>	<b><i>Comment</i></b>
1- Do you think that the application of continuing vocational education will be more effective if carried out through obligatory instructions from the professional associations regulating the auditing profession?	4.17	Second most agreed with
2- Do you think that the professionalism of the auditor is one of the factors affecting the audit practicing environment?	4.35	Most agreed with
5- The commitment to Code of Ethics plays a more effective role in improving the audit practicing environment, than the laws regulating profession practice and companies operations.	3.96	Third most agreed with
<b><i>Fifth Part: The effect of the interested parties on the audit practicing environment.</i></b>	<b><i>Agreement Score</i></b>	<b><i>Comment</i></b>
5- The beneficiaries' continuing interest in following up the auditing procedures provided by the professional	4.40	Most agreed with

authorities and the verification of these authorities' recommendations will help improving the audit practicing environment.		
6- The management philosophy and operating way may affect the audit practicing environment.	4.22	Second most agreed with
7- Obliging the commercial organizations by the governmental supervisory authorities to apply the code of ethics through the business ethics laws and the auditing committees' duties strongly affects the audit practicing environment.	4.21	Third most agreed with

### 7.3 Hypotheses and Analyses

#### 7.3.1 First Hypothesis

Updating of practicing law will partially participate in developing audit environment.

In relation to laws and regulations, "The laws regulating audit practicing and auditors' role" (ranking score of 1.39). With overall ranking as the second variable that affect the professions auditing environment.

Also, "The limited role of the authorities regulating accounting and auditing practicing" was positively correlated with "The outdated Profession Practicing Law", and "The auditor's limited responsibility towards the beneficiaries" (Pearson correlation is 0.195, 0.239 respectively).

Considering "The effect of the governmental authorities and laws on the audit practicing environment general questions", factors were ranked descending according to the following agreement scores:

## The Effect of the Governmental Authorities and Laws on the Audit Agreement Scores

### Appendix (12)

<i>Question</i>	<i>Agreement Score</i>
1-The mutual cooperation between the governmental authorities and professional associations in organizing the auditing profession will help improve the performance of the auditing environment.	4.17
2-Do you think the role of the governmental authorities, laws, financial and professional regulations are one of the factors affecting the audit practicing environment.	4.10
3-Do you think that the non-governmental authorities related to the auditing profession must have a role in formulating the laws affecting the auditing profession environment (companies' laws, commercial laws, stock market laws, and auditing practicing laws) which helps increase the efficiency of the laws and improves the audit practicing environment.	4.05
4-Do you think that the amendment of the laws regulating the companies' operations through clearer definition of the Board role and practicing morals will positively affect the audit practicing environment.	4.04
5-Do you think the selection; appointment and termination of the services of auditor by the General Assembly through the company's internal auditing committee will help increase the efficiency of the auditing profession environment through the auditor's independency.	3.99
6-The role of setting the accounting standards and the supervision of the professional offices should be carried out through the governmental authorities related to auditing.	3.13
7-Do you think that the amendment of the professional laws and regulations has less effect on the audit practicing environment, than the professional associations' role.	2.59

Also, KMO (Kaiser-Mayer-Oklin) and PCA (Principle Component Analysis) tests of practicing general environment variables indicate that law regulating audit practicing has a negative value of (-0.721), which confirms the uncorrelated relationship between applied law and audit practicing environment. This result, as well,



supports our first hypothesis regarding the limited role of laws in enhancing the efficiency of audit practicing environment. Accordingly the main existing problems is "The Profession Practicing Law and its outdated regulating rules", which lead to "The limited role of the authorities regulating accounting and audit practicing ", "Easiness of obtaining the practicing license", and in general increasing "The inconveniency of auditing environment". These results support our first hypothesis.

### 7.3.2 Second Hypothesis

Increasing of the efficiency of audit practicing environment requires structure of all environment fundamental factors in the same time but not with the same degree of importance.

In relation to the laws and procedures; as we discussed in the first hypothesis; "The laws regulating the auditing process and the auditor's role" (ranking score of 1.39), had more effect on the auditing environment than "The efficiency of the professional audit firms procedures", (ranking score of 1.61), where 1 means first ranked and 2 means second ranked. The lower the score the more close the attribute to the first level.

In relation to the practice regulating organizations, "The supervisory governmental organizations controlling auditing quality", (ranking score of 1.75), has effect on the audit practicing environment more than "Non-governmental professional organizations that regulating the audit practicing", (ranking score of 1.77); also more than "Non-governmental international organizations that regulating the audit general environment", (ranking score of 2.48); where 1 means first ranked, 2 means second ranked and 3 means third ranked. The lower the score the more close the attribute to the first level.

In relation to auditing standards, "International auditing standards", (ranking score of 1.33), has effect on the audit practicing environment more than "International financial reports standards", (ranking score of 1.66), where 1 means first ranked and 2 means second ranked. The lower the score the more close the attribute to the first level.

Accordingly the first ranked variable that significantly affect the professions auditing environment is the application "International auditing standards", (ranking score of 1.33), followed by "The laws regulating the auditing process and the auditor's role", (ranking score of 1.39).

This result is far away varied from the applied practicing model in developed

countries, such as United States of America, and United Kingdom, where non-governmental organizations, such as American Institute of Certified Public Accountants (AICPA), and The Institute of Chartered Accountants in England and Wales (ICAEW) are manipulating the practicing environment, controlling any related processes, developing practicing professional plans, and any required practicing law amendments.

### 7.3.3 Third Hypothesis

Increasing of audit practicing firms' quality control procedures will increase the efficiency of audit practicing environment rapidly than other fundamental factors. Considering "The effect of the professional organizations practicing auditing on the auditing environment", factors were ranked descending according to agreement scores:

#### **The Effect of the Professional Organizations Practicing Auditing on the Auditing Environment Agreement Scores**

##### **Appendix (13)**

<i>Question</i>	<i>Agreement Score</i>
1-Keeping the auditors up to date with the changes of the professional requirements (accounting standards, independency, objectivity, policies and procedures) helps activate the auditing general environment.	4.69
2-The mutual understanding between the customers and the professional organizations on the provided services helps improving the performance of auditing general environment.	4.60
3-Do you think the professional organizations working in the auditing field are one of the factors influencing the auditing general environment.	4.38
4-The organizations' use of an effective mechanism to face the failure in the application of quality procedures and policies helps improve the auditing general environment.	4.25
5-The planning for the control arrangements of applying the professional quality in a way that meets the organizational requirements and technical standards helps improving the performance of auditing general environment.	4.23
6-The availability of internal rules at the professional organizations guarantying the regular change of auditors helps improve the audit practicing environment.	4.09

7-The availability of a system for evaluating the efficiency and quality of the relation with the customer has a limited effect on the auditing general environment.	2.72
8-The auditor's awareness of the customer's work field and activities has a limited effect on the audit practicing environment.	2.11

Considering "The effect of the auditors' qualifications on the audit practicing environment." factors were ranked descending according to agreement scores:

### **The Effect of the Auditors' Qualifications on the Audit Practicing Environment Agreement Scores**

#### **Appendix (14)**

<i>Question</i>	<i>Agreement Score</i>
1-Do you think that the professionalism of the auditor is one of the factors affecting the audit-practicing environment.	4.35
2-Do you think that the application of continuing vocational education will be more effective if carried out through obligatory instructions from the professional associations regulating the auditing profession?	4.17
3-The commitment to Code of Ethics plays a more effective role in improving the audit practicing environment, than the laws regulating profession practice and companies operations.	3.96
4-Determining the auditor's annual duties should be based on the vocational training previously received.	3.95
5-Assigning the professional associations to supervise the auditor's commitment to the continuing education requirements will have more effect on the audit practicing environment, rather than assigning the governmental authorities to this job.	3.89

The efficiency and quality of the professional audit firms procedures has ranked as the third variable that affect audit practicing environment, (ranking score of 1.61); where 1 means first ranked and 2 means second ranked. The lower the score the more close the attribute to the first level.

Accordingly, the main existing problems are, the inefficient control over the practicing quality of audit firms, their staff qualifications, experiences, and the

types of services provided to the clients. Statistical analysis resulted in a limited support to this hypothesis. However increasing practicing firms' quality will help in improving audit environment, but its magnitude is neither that strong, nor quicker than other variables. Statistical analyses confirm the necessity of developing auditors' competency. Implementation of both International Auditing standards and updated practicing law may have a higher ranking weight, and stronger magnitude in improving the audit practicing environment. Accordingly they may support the targeted improvements more quickly. We may conclude that our statistical analysis does not fully support the third hypothesis.

### 7.3.4 Fourth Hypothesis

International environment fundamental factors will have a positive effect in practicing environment reform.

Considering of, "The effect of international professional associations on the audit practicing environment", the factors were ranked descending according to the following agreement scores.

#### **The Effect of International Professional Associations on the Audit Practicing Environment Agreement Scores**

##### **Appendix (15)**

<i>Question</i>	<i>Agreement Score</i>
1-The international auditing standards play a key role affecting the auditing procedures and the professional services provided in the local environment regulating the auditing practicing.	4.39
2-The coordination between the international professional organizations and their local counterparts increases the efficiency of the local organizations.	4.39
3-The commitment to the international auditing standards positively affects the local environment regulating the auditing practicing.	4.37
4-The commitment to the performance standards issued by the international professional organizations on the local level increases the beneficiaries' confidence in the audit practicing environment.	4.20
5-Do you think the local laws and regulations should consider the requirements of the international professional organizations?	4.16
6-Do you think the international professional organizations (IFAC,	3.86

IPAC, and OSCO) have a major effect on the local environment regulating the auditing practicing?	
7-Do you think there is a harmony between the objectives of the international professional organizations and their local counterparts.	3.65

In relation to "Defects in some of the applied auditing standards", it was positively correlated with "The lack of auditing standards", (Pearson correlation of 0.358). .

Also, "International auditing standards", (ranking score of 1.33), have effect on the auditing environment more than "International financial reports standards", (ranking score of 1.66), where 1 means first ranked and 2 means second ranked. The lower the score the more close the attribute to the first level.

The least important variable, (ranking score of 2.48) in relation to the effect on the practicing audit environment is Non-governmental international organizations that regulating the audit practicing general environment, such as IOSCO, and IAS that related to an international organization (IFAC), however IASs' are ranked as the first variable that effect local practicing audit environment. This contradiction may be related to the sample respondents' believes of auditing standards importance; however they may not able to actually recognize the current real role of IFAC in their local practicing environment.

Accordingly, International auditing standards are indirectly, but significantly, affecting the local professional audit practicing environment, which is partially supporting our fourth hypothesis.

### 7.3.5 Fifth Hypothesis

The primary factors that expected to have the most important effect in practicing environment reform will be the governmental regulatory bodies and non-governmental associations.

Considering of, "The effect of the non-governmental organizations, and laws on the auditing general environment." Questions related to the "law that regulating

the auditing practice ", were ranked descending according to the following agreement scores:

**The Effect of the Non-governmental Organizations, and Laws on the Auditing General Environment**

**Appendix (16)**

<i>Question</i>	<i>Agreement Score</i>
1-The inclusion of the condition of passing a test after completing the professional program as a requirement for obtaining the license in the auditing practice law will positively affect the audit practicing environment.	4.37
2-The inclusion of the conditions and rules of the auditors' continuing learning in the auditing practice law will positively affect the audit practicing environment.	4.35
3-The inclusion of the condition of having a relative previous experience for obtaining the license in the auditing practice law will positively affect the audit practicing environment.	4.33
4-The inclusion of Code of ethics in the auditing practice law will positively affect the audit practicing environment.	4.31
5-The amendment of the profession laws to include the necessity of applying the international auditing standards will positively affect the audit practicing environment.	4.25
6-The inclusion of a mechanism to regulate the relations between the governmental and non-governmental authorities ruling this profession and the auditing offices and auditors in the auditing practice law will positively affect the audit practicing environment.	4.21
7-The inclusion of the auditor's rights and duties as per the international standards in the auditing practice law will positively affect the audit practicing environment.	4.16
8-The inclusion of the authorities authorized to deal with international professional auditing and accounting associations in the auditing practice law will positively affect the audit practicing environment.	4.04
9-The modification of all types of services provided by auditing offices in the auditing practice law will positively affect the audit practicing environment.	3.71
10-The inclusion of restrictions on the financial relation between the auditor and the customer in the auditing practice law will positively affect the audit practicing environment.	3.55

11-The inclusion of rules determining the auditor's fees in the auditing practice law will positively affect the audit practicing environment.	3.38
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Considering "The effect of the governmental authorities and laws on the auditing general environment" Questions related to the laws regulating the companies' operations were ranked descending according to the following agreement scores:

**The Effect of the Governmental Authorities and Laws on the Auditing General Environment Agreement Scores**

**Appendix (17)**

<i>Question</i>	<i>Agreement Score</i>
1-The inclusion of a condition that guaranties the auditor's independency in the laws regulating the companies' operations will positively affect the audit practicing environment.	4.53
2-The amendment of the laws regulating the companies' operations to include a Code of ethics will positively affect the audit practicing environment.	4.34
3-The amendment of the laws regulating the companies' operations to include a condition obliging the companies to apply the international accounting standards will positively affect the audit practicing environment.	4.29
4-The inclusion of a condition that obliges the auditor to declare the amounts obtained from the customer for services provided other than the auditing in the laws regulating the companies' operations will positively affect the audit practicing environment.	3.81
5-The inclusion of a mechanism that obliges the companies to change the auditor after a determined term (5 years for example) in the laws regulating the companies' operations will positively affect the audit practicing environment.	3.68

Considering of, "The effect of non-governmental professional associations on the audit practicing environment", factors were ranked descending according to agreement scores:

## The Effect of Non-governmental Professional Associations on the Audit Practicing Environment Agreement Scores

### Appendix (18)

<i>Question</i>	<i>Agreement Score</i>
1-Do you believe in the role of professional associations in developing the auditing profession.	4.36
2-The standardization of dealing with the professional associations as a main authority regulating auditing offices and auditors will increase the efficiency and performance of the auditing practicing.	4.30
3-Do you believe in the necessity of activating the professional associations' role to be the main supervisory authority controlling the application of professional requirements.	4.18
4-The effect of non-governmental professional associations is one of the factors influencing the auditing environment.	4.17
5-Dealing with the international professional authorities "IAS Board, IFAC" should be carried out through the professional associations not the governmental organizations related to auditing.	4.15
6-The membership of professional associations must be a requirement for obtaining the practicing license.	4.14
7-Does the Profession Practicing Law need to be ruled by the powers and responsibilities of the professional associations.	4.03
8-The dependency of the professional associations to the governmental legislative authority increases the efficiency of its role affecting the auditing environment.	3.74
9-The professional associations have more effective role on the auditing process than the government authorities regulating the companies' operations.	3.52
10-Do you think that the supervision of the role and performance of professional associations must be carried out by a governmental authority.	3.20

Also, regarding The supervisory governmental organizations controlling audit quality, (ranking score of 1.75), it had more effect on the audit environment than "Non-governmental professional organizations regulating the auditing practicing", (ranking score of 1.77), however both of them were ranked less important in their effect on local audit practicing environment than other variables, such as governing laws and auditing standards. Accordingly, statistical analysis result was not supporting our fifth hypothesis.



The following table summarize the five hypotheses analysis results:

**Hypotheses Analysis Summary Results**  
**Table 5**

	Hypothesis Description	Empirical Results Summary
First Hypothesis	Updating of practicing law will partially participate in developing audit environment.	<p>Empirical results support the first hypothesis due to the followings :</p> <ul style="list-style-type: none"> <li>-Based on the agreement score analysis updating practicing law ranked as the second in importance comparing to the importance of developing the mutual cooperation between the governmental authorities and professional associations.</li> <li>-However, practicing law is considered as one of most important factors in the practicing environment, it also came in the second level, as "The laws regulating the auditing process and the auditor's role" has a high ranking score of 1.39. It was less in environmental importance than "International auditing standards" that has the highest environmental ranking score of 1.33.</li> <li>- Weak (0.301) positive coefficient correlation between practicing laws and both auditors' responsibilities and all other environment variables.</li> <li>- The correlation between audit clients, and practicing laws that regulate audit was weak (0.251)</li> <li>-The negative relation between both outdated Practicing Law and the government supervision and controlling organizations, which regulate audit practicing, the coefficient correlation results were (-0.653).</li> <li>- Non-governmental local professional organizations, regulating audit practicing, have a positive coefficient correlation with outdated Practicing Law (0.492).</li> <li>- KMO and principle component analysis of general environment variables shows a high score of profession outdated law and rules with</li> </ul>

		score (.720), and the associated lack of auditing standards (.604). While the laws regulating the auditing has a negative value of -.721, which indicate that it is uncorrelated to the general practicing environment. Accordingly it supports our hypothesis that law partially affect on practicing environment reform.
Second Hypothesis	Increasing of the efficiency of audit practicing environment requires structure of all environment fundamental factors in the same time but not with the same degree of importance.	<p>Empirical results support the second hypothesis due to the followings :</p> <p>- The importance of each environmental factors were indexed as follow :</p> <ul style="list-style-type: none"> <li>• International auditing standards, (ranking score of 1.33).</li> <li>• The laws regulating the auditing process and the auditor's role, (ranking score of 1.39).</li> <li>• The efficiency of the professional audit firms procedures, (ranking score of 1.61).</li> <li>• International financial reports standards, (ranking score of 1.66).</li> <li>• The supervisory governmental organizations controlling auditing quality, (ranking score of 1.75).</li> <li>• Non-governmental professional organizations that regulating the audit practicing, (ranking score of 1.77).</li> <li>• Non-governmental international organizations that regulating the audit general environment, (ranking score of 2.48).</li> </ul> <p>- KMO and principle component analysis of general environment variables shows an importance ranking of environment components as follows:</p> <ul style="list-style-type: none"> <li>• non-governmental international organizations regulating the auditing profession (.844)</li> <li>• non- governmental professional organizations regulating the auditing work (.805)</li> </ul>

		<ul style="list-style-type: none"> <li>• international financial reporting standards (.804)</li> <li>• The supervisory governmental organizations controlling auditing works (.731).</li> <li>• International Auditing Standards (.581)</li> <li>• Efficiency of professional organization (.510)</li> <li>• -The laws regulating the auditing process and the auditor's law (-.721)</li> </ul>
Third Hypothesis	Increasing of audit practicing firms' quality control procedures will increase the efficiency of audit practicing environment rapidly than other fundamental factors.	<p>Empirical results do not support the third hypothesis due to the followings :</p> <ul style="list-style-type: none"> <li>- The efficiency and quality of the professional audit firms' procedures has ranked as the third variable that affect audit practicing environment, (ranking score of 1.61). Statistical analyses confirm the necessity of developing auditors' competency. Therefore, implementation of both International Auditing Standards and updated of practicing law may have a higher ranking weight, and stronger magnitude in improving the audit practicing environment.</li> <li>- The Pearson correlation result was positive (.158).</li> <li>-The Pearson correlation of developing the clients' audit firms services' procedure presents a positive relation that could enhance practicing environment (.138)</li> <li>- The Pearson correlation of staff periodical update for any new practicing standards' changes was positively correlated to enhancing the professional organization practicing environment (.209)</li> <li>- The Pearson correlation analysis was positive for "the professionalism of the auditor; as one of the factors that affect audit practicing environment" (0.232)</li> <li>- There is a weak positive coefficient correlation of (0.492) between the efficiency of audit firms' followed procedures, and non-governmental</li> </ul>

		<p>professional organizations that regulate audit practicing;</p> <p>- KMO and PCA of general environment variables show a high score of both inconvenience of Egyptian auditing environment (ranking .706), and the auditors' limited responsibility towards the beneficiary (ranking .740).</p>
Fourth Hypothesis	International environment fundamental factors will have a positive effect in practicing environment reform.	<p>Empirical results partially support the fourth hypothesis due to the followings :</p> <p>- "International auditing standards" with ranking score of (1.33), has effect on the auditing environment more than "International financial reports standards", (ranking score of 1.66). While Non-governmental international organizations that regulating the audit practicing general environment have the least affect on practicing environment, (ranking score of 2.48).</p> <p>- Both International Auditing Standards and International Financial Reporting Standards have a strong positive coefficient correlation with the lack of local auditing standards, and the outdated Practicing Law. The results were (0.465, and 0.419), respectively.</p> <p>- There was a strong positive coefficient correlation between International Auditing Standards, International Financial Reporting Standards, and non-governmental international organizations, that regulate audit practicing, with a correlation factor of (0.578, and 0.592)</p> <p>- The coefficient correlation of (.0565) between non-governmental professional organizations that regulate local practicing, and non-governmental international organizations</p> <p>- The KMO and PCA of practicing environment variables shows that both non-governmental international organizations regulating the auditing profession, and International Financial Reporting Standards have a high importance in reforming audit practicing environment with factoring score of (.844 &amp; .804) respectively.</p>

<p>Fifth Hypothesis</p>	<p>The primary factors that expected to have the most important effect in practicing environment reform will be the governmental regulatory bodies and non-governmental associations.</p>	<p>The importance index may be different based on the country level of development and culture. For example developed country, such as US, UK and Canada, have non-governmental practicing regulators that manipulating the practicing environment more than any other environmental factor. This was supported by the KMO and PCA of general environment variables that show a high score for non-governmental international organizations regulating the auditing profession (score .844), and both of non-governmental professional organizations regulating the auditing work (score .805) and the supervisory governmental organizations controlling auditing works (score .731).</p> <p>Even though, Empirical results of Egyptian local practicing environment do not support the fifth hypothesis due to the followings :</p> <ul style="list-style-type: none"> <li>-Both governmental regulatory bodies and non-governmental associations were locally ranked less important in their effect on local audit practicing environment than other variables, (ranking score of 1.75, and 1.77) respectively.</li> <li>-Correlation analysis presented a weak relationship between the efficiency of audit firms' internal practicing procedures and both of local non-governmental and governmental organizations, those responsible of regulating the audit practicing. The correlation factors were (0.312, and 0.042) respectively</li> <li>- Correlation between staff of audit practicing firms, and both of local non-governmental, and governmental organizations that regulate practicing was weak, (0.337, and 0.060) respectively</li> <li>- The correlations between audit clients and both of local non-governmental and governmental organizations, which regulating practicing, were positively weak, (0.435, and 0.294) respectively</li> <li>- Non-governmental international organizations that organize audit practicing have a positive regression factor of (0.469), which is higher than</li> </ul>
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		<p>the positive (0.387) regression factor of local non-governmental professional organizations. This is due to weakness and the ineffective role of local non-governmental organizations.</p> <p>- The government supervision and controlling organizations, which regulate audit practicing, have a positive regression of (0.539). However, their coefficient correlation indicates a negative relation with both outdated Practicing Law and lack of auditing standards. Also, it indicates a positive relation with the easiness of obtaining practicing license. The coefficient correlation results were (-0.653, -0.447, and 0.553), respectively.</p>
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#### 7.4 Empirical Analysis Discussion and Results Conclusion

Researchers in accounting literatures have tried to study individually each of the previous analyzed five constructs (variables). Many researchers studied the process of auditors' ethical decision while others studied the effect of laws and regulations on audit practicing, but none of them have measured the correlations, and the effect of those overall variables on the overall audit environment.

In this research we tried to present an empirical examination of the validity and correlation between suggested five key constructs (variables) of the general audit practicing environment, and their relationship with our suggested hypotheses. The underlying assumption beyond our argument was mainly that there are some main constructs (variables) that should be seen from the point of their interrelation, and the overall general audit practicing environment. This concept can be considered as a government public management policy that improves the overall performance of both audit practicing and local economy. However, we believe that the correlation and the magnitude of each construct (variable) will be different from one country to the other based on its local fundamentals, such as community culture, structure, and economy sophistication. Accordingly, we suggest that future researches can study the comparison between these constructs between different countries.

Our current study is an explanatory one. However, we tried to present it in

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a comprehensive approach. It is important to mention that the study has some limitations. Most of the studies related to the same subject, particularly in audit regulation filed, were mainly focus on audit technical issues. There are a limited number of audit studies that tried to investigate audit environmental variables, or measure their expected effect on the general audit practicing environment. We tried to structure the bases for building a model that can be used by future researchers to construct an initial theory that measure the relationship between audit practicing environmental variables, and their effect on audit services development; accordingly we also recommend that future studies in the same field may focus on developing an integrated theory in the field of practicing environment development.

#### 7.4.1 Empirical Analysis

The contingency organizational theory suggests that any organization is consist of number of systems that supported by subsystems and directed by specific boundaries from its surrounding environmental subsystems. The theory analysis helped in understanding the interrelationships between the subsystems, the organization environmental patterns, and other related variable. The theory argued that organization environmental structure is the major source for organization management. Accordingly organizations always trying to interpret their surrounding environment, in order to maximize their advantages, and use the out puts knowledge to reshape their operations (**Richardson, 2009**). Based on the environmental theories we tried to study the environment phenomena and its effect on audit practicing. We proposed a conceptualization of practicing environment that consists of both internal and external environment dimensions as presented in Figure (3). The environmental proposed dimensions are treated as exogenous constructs (independent variables) that affect the audit practicing system; the relationships among the components of those dimensions are not specifically hypothesized. The characteristics of local environmental and weakness points are treated as endogenous constructs (dependent variables). The conceptual model framework is a causal modeling.

**7.4.1.1 Professional Organizations Internal Environment (correlation and Regression Analysis)**

The following Appendix presents a summary of Professional Organizations internal environment correlation and regression analysis:



## Summary of Professional Organizations Internal Environment Correlation and Regression Analysis

### Appendix (19)

Pearson correlation	Correlation	
Q 10.1	q9_6	Q10.1
	f- Inconvenience of auditing environment	i- The efficiency of the professional organizational procedures
<b><u>The effect of the professional organisations practicing auditing on the auditing environment</u></b>		
1- The mutual understanding between the customers and the professional organisations on the provided services helps improving the performance of audit practicing environment.	0.138	0.165
2- The availability of a system for evaluating the efficiency and quality of the relation with the customer has a limited effect on the auditing job environment.	0.115	0.02
3- The planning for the control arrangements of applying the professional quality in a way that meets the organisational requirements and technical standards helps improving the performance of	0.176	0.158
4- The auditor's awareness of the customer's work field and activities has a limited effect on the	0.218	0.04
5- Keeping the auditors up to date with the changes of the professional requirements (accounting standards, independency, objectivity, policies and procedures) helps activate the auditing job	0.066	0.209
6- The availability of internal rules at the professional organisations guarantying the regular rotation of auditors will help in improving the audit profession environment.	0.041	0.091
7- The organisations' use of an effective mechanism to face the failure in the application of quality procedures and policies helps improve the auditing job environment.	0.017	0.135
8- Do you think the professional organisations practicing in the auditing field are one of the factors that influencing the auditing practicing environment?	0.002	0.026
<b><u>The effect of the auditors' qualification on the auditing work environment</u></b>		
1- Do you think that the application of continuing vocational education will be more effective if carried out through obligatory instructions from the professional associations regulating the auditing	0.141	0.097
2- Do you think that the professionalism of the auditor is one of the factors affecting the audit	0.232	0.066
3- Assigning the professional associations to supervise the auditor's commitment to the continuing education requirements will have more effect on the audit practicing environment rather than	0.036	0.166
4- Determining the auditor's annual duties should be based on the vocational training previously	0.178	0.07
5- The commitment to Code of Ethics plays a more effective role in improving the audit practicing environment than the laws regulating profession practice and companies work.	0.029	0.12
<b><u>The effect of the Stakeholders on the audit practicing environment</u></b>		
1- Do you think that the interested parties and beneficiaries (Stock companies managements, banks, governmental and supervisory authorities) are one of the factors affecting the audit practicing	0.073	0.03
2- Do you think that the main interest of the beneficiaries is to obtain the financial statements, information summary and the financial policies rather than obtaining efficient recommendations or realizing the scope of work and procedures applied by the professional authorities?	0.105	0.175
3- Do you think that the companies' managements growing awareness of their social responsibilities helps increasing the performance and efficiency of the audit practicing environment?	0.221	0.036
4- The meeting of the beneficiaries' unusual requirements is one of the auditing priorities.	0.086	0.132
5- The beneficiaries' continuing interest in following up the audit notes and recommendations provided by the professional audit firms and the verification of these recommendations will help	0.105	0.016
6- The management philosophy and operating way may affect the audit practicing environment.	0.163	0.019
7- Obliging the commercial organisations by the governmental supervisory authorities to apply the code of ethics through the business ethics laws and the auditing committees' duties strongly affects	0.079	0.177

We have classified the main internal environmental variables that may affect the audit firms into three:

**1<sup>st</sup> Practicing internal procedures;**

**2<sup>nd</sup> Practicing recourses (auditors' qualification); and**

**3<sup>rd</sup> Stakeholders / audit firms clients.**

SPSS software was used in analyzing both of correlation and regression analysis for these variables that related to local audit practicing firms. Following is a summary of analysis main results:

**1<sup>st</sup> Practicing internal procedures**

- Analysis results confirmed that local audit firms are not implementing any procedures to agree with their clients about the expected services. This weakness is affecting negatively the audit firms practicing with a Pearson correlation (.165). However, the Pearson correlation of this procedure presents a positive relation that could enhance practicing environment (.138), which propose that local audit firms are neither focusing on the types of services they provide to their clients, nor following the pre-engagement evaluation procedures that are required by international auditing standards.
- Regarding audit firms implemented internal quality procedures and their effect on the practicing environment, the Pearson correlation result was positive (.158). However, the result was (.176) in relation to actual implementation of these procedures by local practicing audit firms, which lead us to conclude that most of local audit firms do not follow any internal quality procedures
- Regarding following of internal procedures for developing audit staff knowledge and skills, the Pearson correlation was (.218), which confirms the none following of these procedures. The Pearson correlation result was positively weak (.040) in relation to the effect of these procedures on enhancing practicing environment. On the other edge, the periodical update of staff for any new practicing standards' changes was positively correlated to enhancing

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the professional organization practicing environment with Pearson correlation (.209)

### **2<sup>nd</sup> Practicing recourses (auditors' qualifications)**

- The Pearson correlation analyses shows a positive relationship between auditors following of both code of conducts, auditing standards requirements to monitor continuous education, and enhancing audit firms internal practicing environment (0.120, and 0.166), respectively.

On the other hand, the Pearson correlation analysis was positive for “the professionalism of the auditor; as one of the factors that affect audit practicing environment” (0.232), which confirms the importance of developing staff professionalism, and their strong relation to enhance practicing environment.

### **3<sup>rd</sup> Stakeholders / audit firms clients**

- Pearson correlation results related to clients' internal control procedures was negative (-0.177), which indicates a weak relationship between clients implementation of code of ethics and internal control procedures, and enhancing of audit practicing environment.
- In relation to increasing of clients' understanding of their social responsibilities, and enhancing of audit practicing environment, the Pearson correlation was positive (0 .222).

## **Internal Environment Correlation Analysis**

We tried to analyze the relationship between both of audit firms internal environment variables, and audit practicing environmental variables through measuring the correlation between both of these variables, the analysis results are summarized as follows:

- **1<sup>st</sup> Practicing Internal Procedures**

Correlation analysis presented a weak relationship between the efficiency of audit firms internal practicing procedures and both of local non-governmental, and governmental organizations, those responsible of regulating the audit practicing. The

correlation factors were (0.312, and 0.042) respectively, which indicates the limited role that those organizations play for regulating, monitoring, and control local audit practicing firms. Those organizations' role is critique, and needs to be more active to comply with international auditing standards requirements, mainly, if we considered the key role of audit practicing firms and professional organization in both of economy and society.

- **2<sup>nd</sup> Practicing recourses (auditors' qualifications)**

Correlation between staff of audit practicing firms, and both of local non-governmental, and governmental organizations that regulate practicing was weak, (0.337, and 0.060) respectively, which indicates that both of local non-governmental and governmental organizations have no effect on enhancing audit practicing professions or the practitioners.

- **3<sup>rd</sup> Stakeholders / audit firms' clients**

The correlations between audit clients and both of local non-governmental and governmental organizations, which regulating practicing, were positively weak, (0.435, and 0.294) respectively. Also the correlation between clients, and practicing laws that regulate audit was weak (0.251). These weak correlations' results confirmed that internal local practicing environment is Stale / Dormant and need major reforms in order to increase its operating organizations effectiveness.

#### **7.4.1.2 External General Environment Correlation and Regression Analysis**

The following Appendix presents a summary of external practicing environment correlation, and regression analysis:

## Summary of External Practicing Environment Correlation, and Regression Analysis

### Appendix (20)

Regression & Coefficients Analysis for local Practicing Environmental Weakness	q9_1	q9_2	q9_3	q9_4	q9_5	q9_6	q9_7	Q10.1	Regression
<b>a- Laws and Procedures:</b>									
1- The efficiency of the professional organization procedures	0.081	-0.174	0.161	-0.183	-0.066	-0.361	0.084	0.000	0.342
2- The laws regulating the auditing process and the auditor's role	-0.061	0.016	-0.187	-0.148	0.285	-0.129	0.067	-0.114	0.279
<b>b- Organisations:</b>									
1- Non governmental professional organisations regulating the auditing work	-0.140	0.057	-0.492	0.244	-0.306	-0.174	0.306	-0.355	0.387
2- The supervisory governmental organisations controlling auditing works	-0.447	-0.097	-0.653	0.203	-0.553	0.163	0.541	0.206	0.539
<b>3- Non governmental international organisations regulating the auditing profession</b>	-0.556	0.114	-0.475	0.021	-0.349	0.081	0.361	0.011	0.469
<b>c- Standards:</b>									
1- International auditing standards	-0.086	-0.160	-0.466	-0.104	-0.160	-0.123	0.121	-0.139	0.329
2- International financial reporting standards	-0.419	-0.024	-0.140	-0.099	-0.281	-0.279	0.438	-0.127	0.353

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We have empirically analyzed the regression analysis for both current weakness elements in the Egyptian practicing environment, and their effect on the audit-practicing environment. The results proposed the major environmental variables that have a strong impact on those weakness elements. The following is a summary discussion of these variables:

- A. The government supervision and controlling organizations, which regulate audit practicing, have a positive regression of (0.539). However, their coefficient correlation indicates a negative relation with both outdated Practicing Law and lack of auditing standards. Also, it indicates a positive relation with the easiness of obtaining practicing license. The coefficient correlation results were (-0.653, -0.447, and 0.553), respectively. This confirms the necessity of increasing the role that government professional organizations play in developing the local practicing environment, which can be achieved through using the government regulatory authorities in order to reorganize the weight of local environmental variables.
- B. Non-governmental international organizations that organize audit practicing have a positive regression factor of (0.469), which is higher than the positive (0.387) regression factor of local non-governmental professional organizations. This result represents a deviation from the actual practicing model in developed countries, as local non-governmental professional organizations always play the key role in profession regulating. Accordingly, we assume that the current statistical analysis results are due to weakness and the ineffective role of local non-governmental organizations.
- C. Non-governmental local professional organizations, regulating audit practicing, have a positive coefficient correlation with both outdated Practicing Law and audit firms' practicing procedures (0.492, and 0.354). This indicates the need to have a stronger role of non-governmental local professional organizations to support practicing environment reform procedures.
- D. Both International auditing standards and International financial reporting standards have a strong positive coefficient correlation with the lack of local auditing standards, and the outdated Practicing Law. The results were (0.465, and 0.419), respectively, which confirms the important role that both auditing and accounting reporting standards can play a part in developing the practicing

local environment. The results also indicate the necessity of considering those standards as an integrated part of any practicing law reforming procedure.

#### **7.4.1.3 KMO (Kaiser-Mayer-Oklin) and PCA (Principle Component Analysis) Test**

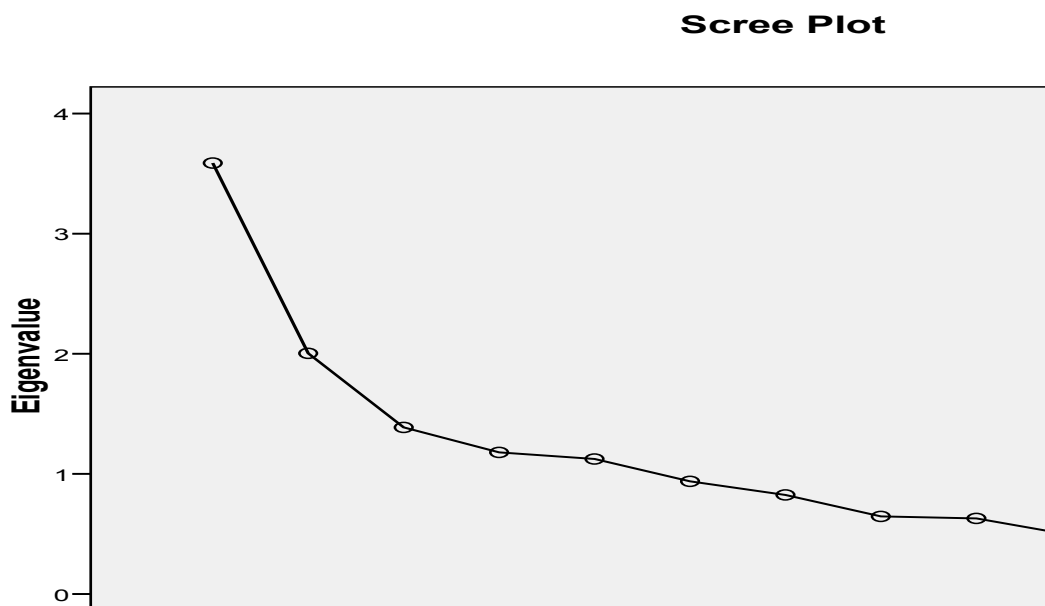
We used the SPSS to prepare KMO (Kaiser-Mayer-Oklin) and PCA (Principle Component Analysis) for the two general type tested questions about the expected weighted average and importance of the practicing environmental main three factors (laws, practicing related organizations, and practicing related standards), as well as, the currently expected deficiencies in the Egyptian practicing environment. These analysis are used to support the other used statistical techniques during the data empirical study.

However, the tested sampling size is not that big, only 105 sample units tested, the factoring analysis technique is still visible due to the tested variables linear correlation. The KMO value is more than 0.6. Also, the Bartlett test significant value is less than .05, which indicates that factor analysis is appropriate for the tested data. The tested data plot shape is systematic and taking a horizontal trend as presented in Figure 10.

As per appendix 21 the Eigen values  $>1$ , which resulted in generate five main components that represents 66% of cumulative variances. In order to increase the confidence degree in the generated components we used different software, Monte Carlo PCA, in order to computes a random parallel analysis criteria for SPSS generated Eigen values. Based on this test we decided to discuss the components that have SPSS generated Eigen values more than those randomly generate by Monte Carlo PCA. Accordingly, we discussed only the first three components. Appendix 22 presents the comparison between SPSS and Monte Carlo PCA Eigen values.

Also the component correlation matrix (appendix 23) shows a low degree of correlation between the different factors results, therefore the factors rotation test was not necessary.

**Figure 10: Scree Plot**



**Total Variance Explained**

**Appendix 21**

Component	Initial Eigen values			Extraction Sums of Square Loadings			Rotation of Squared Loadings(a)
	Total	% of Variance	Cumulative %	Total	% of Variance	Cumulative %	Total
1	3.588	25.628	25.628	3.588	25.628	25.628	3.522
2	2.004	14.312	39.940	2.004	14.312	39.940	1.901
3	1.387	9.908	49.848	1.387	9.908	49.848	1.524
4	1.179	8.421	58.269	1.179	8.421	58.269	1.306
5	1.124	8.029	66.297	1.124	8.029	66.297	1.309
6	.938	6.701	72.998				



**Monte Carlo PCA, Random Parallel Analysis****Appendix 22**

Component Number	SPSS Eigen values	Monte Carlo PCA random Eigen values
1	3.588	1.6969
2	2.004	1.5025
3	1.387	1.3650
4	1.179	1.2516
5	1.124	1.1768

**Component Correlation Matrix****Appendix 23**

Component	1	2	3	4	5
1	1.000	.049	.122	-.087	-.023
2	.049	1.000	-.005	-.065	.152
3	.122	-.005	1.000	.070	.008
4	-.087	-.065	.070	1.000	.033
5	-.023	.152	.008	.033	1.000

Extraction Method: Principal Component Analysis.

Rotation Method: Oblimin with Kaiser Normalization.

**7.4.1.4 KMO and PCA Results Discussion**

Both of pattern matrixes, appendix 24, and structure matrix appendix 25 give the same variables loading values with insignificant differences. In the following part we will discuss the factoring analysis result based on the pattern matrix values:

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### **First Component**

The first component includes the different types of practicing organizations that monitoring and control the audit profession. The highest loading value is associated with non-governmental international organizations that influencing the audit practicing with a weighted score of 0.844. While the second loading highest value, with weighted score of 0.805 is in favor of the local supervisory non-governmental organization that monitoring and control the audit profession. International reporting standards have the third ranking within the first factor with weighted loading score of 0.804. While the lowest loading ranking is associated with the local governmental organizations that regulating audit practicing with a score of 0.731.

The component structure reflects the importance of governing audit practicing organizations in shaping of an idle professional environment. In contrary, the Egyptian local practicing environment is ranking these governing organizations in a lower environmental value due to the inconvenience of the local environment. Both of the Egyptian governmental regulatory bodies and non-governmental organizations are ranked as lower variables that may help in enhancing the efficiency of practicing audit environment, ranking score is 1, 75 and 1.77 respectively. Also, the non-governmental international organizations that influencing the audit practicing are classified as the lowest environmental variable in Egyptian practicing environment with a ranking score of (2.48).

### **Second Component**

The second component presents the loading of the Egyptian audit practicing environmental deficiencies and its associated inconvenience of audit environment that has the highest component loading score of 0.706, as well as, the auditor's limited responsibilities towards the audit services beneficiaries that ranked as the lowest loading score with 0.604.

### **Third component**

Third component presents the loading of the Egyptian audit practicing regulating deficiencies, such as outdated practicing law and regulations that has the highest component loading score of 0.720. While the lack of associated audit standards has the lowest loading score (0.604).

**Pattern Matrix**  
**Appendix 24**

	Component				
	1	2	3	4	5
q10_b3	.844				
q10_b1	.805				
q10_c2	.804				
q10_b2	.731				
q10_c1	.536				
q10_a1	.510	.396	-.372		
q9_4		.740			
q9_6		.706			
q9_3			.720		-.361
q9_1		-.503	.604		
q9_7	-.334	.301	.508		
q9_5	.311			.776	
q10_a2				-.721	
q9_2					.879

Extraction Method: Principal Component Analysis.

Rotation Method: Oblimin with Kaiser Normalization.

a Rotation converged in 19 iterations.

## Structure Matrix

## Appendix 25

	Component				
	1	2	3	4	5
q10_b3	.849				
q10_b1	.809				
q10_c2	.784				
q10_b2	.730				
q10_c1	.581				
q10_a1	.481	.468	-.312		.325
q9_6		.725			
q9_4		.725			
q9_3	.325		.731		-.336
q9_1		-.453	.642		
q9_7		.313	.481		.343
q9_5				.741	
q10_a2				-.738	
q9_2					.870

Extraction Method: Principal Component Analysis.

Rotation Method: Oblimin with Kaiser Normalization.

#### 7.4.1.5 External General Environment Correlation Analysis

We analyzed the correlation between all of the suggested external environment variables in order to confirm our understanding of their interrelation effects. The following is a summary of analysis results:

- 1. Weak positive coefficient correlation (0.492) between the efficiency of audit firms' followed procedures and non-governmental professional organizations that regulate audit practicing;
- 2. Weak (0.301) positive coefficient correlation between practicing laws and both auditors' responsibilities and all other environment variables. The weakest coefficient correlation was for non-governmental professional organizations that regulate practicing;
- 3. In relation to organizations that regulate and monitor audit practice, there was a strong positive correlation between the three main regulatory organizations. The coefficient correlation between non-governmental professional organizations that regulate local practicing, and both governmental regulatory bodies and non-governmental international organizations were (.0606, and .0565), respectively, which indicates the importance of integrating these organizations' efforts during development of the practicing environment; typically, this can be achieved by increasing the role, authorities, and responsibilities of non-governmental professional organizations.
- 4. There was a strong positive coefficient correlation between International Auditing Standards, International Financial Reporting Standards, and non-governmental international organizations, that regulate audit practicing, with a correlation factor of (0.578, and 0.592), respectively, which confirms the strong integration between all of these variables, the importance of their parallel implementation, and the necessity of increasing cooperation between local and international professional non-governmental organizations.

### 7.4.2 Empirical Discussions

Any organization is an open system that continuously interacts with its surrounding environmental variables; accordingly, congruence is required to harmonize the environmental internal and external variables and the dominant behaviors of the organization. Environmental changes do not usually require cultural changes. Culture changes involve a total restructuring of the environment, through changing the societal expectations (including regulation or deregulation). Due to the unique fundamentals and inefficiency of the Egyptian practicing local environment, and based on the empirical analysis results that were previously discussed, we may conclude that the Egyptian practicing local environment requires a deep culture change.

Some researchers in the field of management environment, such as **Gordon (1991)**, suggests that changing the environment through imposing government actions does not always lead to the targeted outcomes. This assumption is not applicable for audit-practicing professions, as audit practicing is a key function in servicing society and protecting its interests, and accordingly it should be properly regulated.

Also, some environment early researches argued that close controls centralization through tightening laws and regulations will increase both governmental and non-governmental organizations' roles. Furthermore, this will decrease environmental uncertainty, and enhance the efficiency of the practicing environment.

In general, many organizational environments' researches concluded that organizations usually perform well, and properly understand customers' expectations, if they are working in a friendly, simple, and stable environment that offer substantial resources (**Child, 1972; Cameron & Quinn, 2006**). These high-performance organizations always have minimum environmental changes to deal with, thus they will be more focused on improving efficiency (**Porter, 1985; Patrick & Maister, 2001**). Based on the previously discussed literatures, we may conclude that the audit-practicing environment, in general, can be classified as a stable and complex environment, since there are many elements and variables included in this type of environment. However, these elements and variables are usually constant and change slowly. The recent financial scandals dramatically shifted the practicing environment's designation to be more complex, unstable, and uncertain. This shift resulted in many changes of law and regulations that govern practicing.

**Pfeffer and Salancik (1978) and Brickley et al. (2003)** argue that greater uncertainty increases efforts to more centralization and coordination, which encourage formalizing of larger organizations through merger and acquisitions in order to face the increasing environment regulating steps and political control. The following Table 6 presents the main characteristics of practicing local environment:

**Characteristics of Practicing Local Environment**  
**Table 6**

<b>Environment Dimension</b>	<b>Reasons of Classification</b>	<b>Local Environmental variables that Support the Classification</b>
Complex/ State	Degree to which the environment variables remain basically the same over time, or without continual change; -Ineffective role of the variables; -Inefficient performance of the variables; -Non-active interrelation between the variables	<ul style="list-style-type: none"> <li>- Practicing environment has many variables that affect it;</li> <li>-Weak governing rules and regulatory bodies;</li> <li>-Unorganized and inefficient interrelationship between governmental and nongovernmental organizations that regulate and control the practicing decisions environment; including unavailability of clear vision, mission or strategy for these organizations;</li> <li>-Poor practicing qualifications and rarity of human resources;</li> <li>-Outdated practicing law;</li> <li>-Inefficient relationship with international professional organizations;</li> <li>-Improper development of local accounting and auditing standards, which are not in line with similarly used international standards;</li> <li>-Unavailability of local code of ethics or independency roles;</li> <li>-Improper interrelation between business industry laws and practicing regulations;</li> <li>-Unclear responsibilities of audit firms against stakeholders and community;</li> <li>-Unclear strategic goals or mission statement for audit-practicing firms.</li> </ul>
Uncertainty	The trait of the environment resulting from the two powerful forces of complexity and state	<ul style="list-style-type: none"> <li>-No available clear structure of organizations that regulates professional practicing;</li> <li>-No available authorized institutions to monitor quality of services provided by practicing audit firms;</li> <li>-No clear structures, or working procedures in most local practicing firms;</li> </ul>

		<ul style="list-style-type: none"> <li>-Weak organizational culture of the most practicing audit firms;</li> <li>-Local professional practicing organizations are not generally following the global pattern or speed of development.</li> </ul>
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Any environment changes require two levels (assumptions level and value level), therefore, empowering practicing organizations is necessary to meet both external and internal environment challenges. The successful implementations of these changes require modernizing of laws and regulations that organize audit practicing. They also require increasing the supported government and non-governmental governing bodies that regulate the practicing environment, in addition to creating proper strategic plans that provide effective communication between all environment key players through integrating their efforts to achieve the targeted overall development of the practicing environment.

### 7.4.3 Empirical Results and Conclusion

In general, we extended our study research to understand the relationship between both the external and internal practicing environmental. We connected our measures to previous works in the field of the organizational environment, which provide us with the base to identify five practicing environmental constructs (variables) that consist of Non-Governmental Associations (Organizations), Audit Firms/Professional Organization, Governmental Regulatory Bodies (Organizations), Practicing Laws Auditors Characteristics, and International Associations. We identified the classification of Egypt's current practicing environment as dormant, complex, and uncertain. Also, we proposed that the local audit practicing environment is neither working efficiently nor effectively.

Based on our empirical analyses results and findings, there are a number of interesting observations related to the audit-practicing environment, services quality, and controls that may affect audit practicing in Egypt. The following Appendix (26) summaries these observations, which are closely related to Egypt's local practicing environment's main weaknesses:



### Empirical Analyses Observations Summary

#### Appendix 26

Schedule I	Exists	Does not exist	To a certain extent
<b>a-</b> Lack of auditing standards.	<b>29%</b>	<b>41%</b>	<b>30%</b>
<b>b-</b> Defects in some of the applied auditing standards.	<b>33%</b>	<b>30%</b>	<b>37%</b>
<b>c-</b> Outdated Audit Practicing Law and regulations.	<b>61%</b>	<b>13%</b>	<b>26%</b>
<b>d-</b> Auditor's limited responsibilities toward the beneficiaries.	<b>42%</b>	<b>22%</b>	<b>37%</b>
<b>e-</b> Easiness of obtaining practicing license.	<b>56%</b>	<b>21%</b>	<b>24%</b>
<b>f-</b> Inconvenience of auditing environment.	<b>52%</b>	<b>12%</b>	<b>36%</b>
<b>g-</b> The limited role of authorities regulating accounting and auditing.	<b>64%</b>	<b>9%</b>	<b>27%</b>

Also, Appendix 27, indexes, in a ranking base, the different environment variables based on their magnitude on the audit-practicing environment:

#### Ranking Base of Practicing Environmental Variables

#### Appendix 27

Schedule II	Ranking Score
<b>a- Laws and Procedures:</b>	
1- The efficiency of the professional organization's procedures.	1.61
2- The law regulating audit practicing and the auditor's role.	1.39
<b>b- Organizations:</b>	
1- Non-governmental professional organizations that regulate auditing practice.	1.77
2- Monitoring governmental organizations that control audit practicing.	1.75
3- Non-governmental international organizations regulating audit practicing.	2.48
<b>c- Standards:</b>	
1- International auditing standards.	1.33

2- International financial reporting standards.	1.66
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In summary, the empirical analyses results reveals that both local non-governmental and governmental organizations play a limited role in regulating Egypt's local practicing organizations compared to what is supposed to be as per international practicing standards. This limited role resulted in an inefficient and ineffective correlation between both the local practicing environment and practice professions, which is contrary to what is expected in a fully regulated practicing business. Local law regulating practicing does not present any interrelation, neither through regression nor correlation analysis, with any of the current weakness problems indicated in the local practicing environment, except for those related to the easiness of obtaining practicing licenses. These indicate the weakness and ineffectiveness of currently used practicing law, and confirm the immediate necessity of law reform procedures. The negative factors that are currently presented in the Egyptian local practicing environment led us to classify it as a complex and dormant environment with a limited degree of uncertainty. These types of environment need major reform procedures, mainly through increasing the role of both governmental and non-governmental professional organizations.

The empirical findings, in general, confirmed that the Egyptian audit practicing law and professional regulatory bodies need to be reformed. Also, local professional auditors need to integrate their best practices in order to enhance their audit firms' practicing quality, and use procedures that monitor and evaluate the professional practicing process.

## **Chapter 8**

# **Suggested Practicing Reform in Egypt**

## **Chapter 8: Suggested Practicing Reform in Egypt**

Based on the previously discussed empirical research results, in this section we will attempt to discuss the main suggested factors that support the development of the local audit practice environment, and increase the quality of services provided by the local governmental organizations, non-governmental organizations, and practice audit firms.

The current local practicing basic grounds are limiting necessary legislative reforms. Local faulty legislative practicing system has institutionalized a corrupt set of structures that led to biased decisions, occasionally outright corruption, and created an unethical wasteful system. Accordingly, the Egyptian government should strive to create efficient changes to the audit-practice environment (**IFAC, 2003**).

### **8.1 Practicing General Reform Conceptual Framework**

It is essential for regulators and practicing standards' developers to ensure that the fundamental focus is not compromised by other interests' intervention, whether commercial or political. Therefore, the practicing reform's conceptual framework must focus on individual auditors development in order to support their professional judgment skills and capabilities to protect shareholders' interests through the fair presentation of financial information. Egyptian regulators should also recognize the importance of applying IFAC Code of Ethics as the base for national independency codes of conduct (**IFAC, 2003**). Thus, proposed practicing law amendments should include articles stating that the audit should be performed through use of international accounting and auditing standards.

#### **8.1.1 Practicing General Reform Procedures**

Developing of practicing performance quality involves changing the accounting and auditing statutory framework. The initial step in any reform must start with ensuring that practice law and regulations provide proper protection for public interests. The following are the key proposed reform steps that have been extracted from the research survey questionnaire answers:

- Establishing of an accounting and auditing oversight body that will be responsible for monitoring audit practice activities. This body mainly consists of individuals and groups of experts in accounting and auditing (**Rahman et al., 2002**).

**The oversight body functions will focus on:**

- Preparing auditing standards for legislation;
- Formulating auditing and assurance standards' guidance; and
- Representing the local professions internationally.

**The oversight body powers of authorities can be extended to:**

- Engaging staff and consultants;
  - Establishing committees and consultative groups; and
  - Receiving money contributions to compensate its operating costs.
- Apply International Auditing and Accounting standards as a law.
  - Develop proper monitoring and reporting mechanisms, including peer-review programs.
  - Establish Competency Standards Committee to monitor the adequacy of professional and business ethics. This committee stands as an independently produced occupational point of reference or benchmark. The committee also should be under the joint sponsorship of the Ministry of Finance, the Capital Market Authority, and the Central Bank of Egypt. The committee will also be authorized to conduct independent practice review of auditors and audit firms, imposing disciplinary sanctions against professions responsible for noncompliance with auditing standards and code of professional ethics. The committee will set up regulations that oblige every audit firm, regardless of its size, to place a quality-control system over its practice (**CICA, 2005**).
  - Monitor auditors' annual independency declaration, and perform periodic independency tests to confirm that both practicing auditors and audit firms have the proper independency mechanism.

- Prohibit any kind of employment or financial relationships between auditors and their clients.
- Legalize the establishment of mandatory audit committees for listed companies (**El-Din, 2005**).
- Apply compulsory audit partners' rotation program, in order to avoid buildup of long-term audit relationships, and reduce the independency risk. Auditors should not play a significant role in the audit of the company or scheme for more than five out of seven successive financial years. Also there should be a period of at least two years before the auditor can again be involved with the same client re-audit.
- Impose all publically listed companies to report their auditor's change to the Egyptian Stock Exchange within a limited period from the changing date; companies should also disclose the reasons beyond auditors' disassociation (**Beneish et al., 2001**).
- Impose a Professional Code of Ethics for all auditors, which is mainly built based on the fundamental principles of professions, integrity, objectivity, competency, due care, confidentiality, and professional behavior. (**Reiter, 1997**).
- Apply licensing system that meets IFAC requirements and international best practice, such as imposing the necessity of practicing qualification exams, proper practical experience for a number of years, and yearly continuing education scheme (**IFAC 2003**).
- Implement maximum civil penalty for audit misleading or fraud (**Moore et al., 2005**).
- Oblige chief executive officer and chief financial officer of audited companies to sign the company's audited financial statements.
- Impose auditors to form an opinion on the company's corporate governance standards.
- Prohibit auditors from providing their audited clients with non-audit services, mainly for joint stock companies, except in cases approved by the clients' audit committee.

### 8.1.2 Enhancing the Role of Other Regulatory Agencies/Ministry of Finance

The role of the ministry of finance (MOF) in any future developing process of the audit-practicing environment should be more positive. MOF should have more powerful

controlling and monitoring authorities in order to properly act on behalf of the government, therefore, it should have the right to:

- Give a professional accounting body ESAA, “Egyptian Society for Accountants and Auditors,” a written notice to request a copy of the society's code of professional conduct, and any related amendments. Also, MOF should be able to request ESAA to provide information about the current and planned quality-assurance reviews, and investigate disciplinary procedures;
- Request any local audit firm or individual auditor to provide information about any completed audit assignment, and the audit procedures followed during this assignment;
- Punish and penalize any audit firm, or individual auditor, that commits any non-complying auditing or accounting standards offence.

## **8.2 Developing the Quality of Audit-Practicing Organizations**

Audit-practicing organization development depends on the decisions taken within the organization. These organizations should be a key part of any practicing development efforts. The following part presents the crucial factors that should be considered in order to increase efficiency of local professional organizations.

### **8.2.1 Developing the Role of Egyptian Society of Accountants and Auditors (ESAA)**

Developing the role of ESAA is critical for any future reform efforts. ESAA’s core task should be focused on acting with integrity, objectivity, excellence, and commitment to the public interests. One of the ESAA’s main functions should be to ensure that newly qualified auditors have the required competencies and qualifications to be able to meet global sophisticated challenges, and the rapidly changing marketplace. The following are the focal aspects that should be considered during designing an ESAA development plan:

- Regularly examine the appropriateness of overseeing public interests mechanism, supporting continuous education, and training quality of accountants and auditors (**Rahman et al., 2002**).

- Monitor the recent changes on the international accounting and auditing standards, and evaluate their effects on the local profession.
- Review of both auditors and audit firms' compliance standards, and impose actions against violators.
- Assess the effectiveness of local audit firms' operating systems to ensure their independency compliance. Measure the adequacy of auditors' local independency rules, Audit Practicing Act, and Codes of Professional Conduct.
- Perform periodic quality-assurance reviews for the local audit firms.
- Monitor companies' compliance procedures in relation to disclosures' arrangement rules and regulations.
- Provide its members with a future clear vision of the professions that help them to shape their practicing development plan throughout their careers.
- Provide guidance of expected competencies for newly qualified professional auditors.
- Support Ministry of Finance activities through providing it with a yearly report that discusses the society performance, and any actions taken against any individual auditor or audit firm.

### **8.2.2 Improving Audit Firms' Quality Management**

Effectiveness of audit firms' quality-control systems depends on their staff skills, integrity, objectivity, intelligence, and competency (**IFAC, 2003**). Generally, the more experience of the staff, the less direct supervision needed. Audit firms should have proper personnel management policies and procedures to maintain their staff quality. This can be achieved through encompasses hiring, assigning personnel competencies, professional development, and advancement activities (**AICPA, 2003**).

The nature, extent, and formality of an audit firm's quality-control procedures should be comprehensive and efficiently designed to fit with the firms' size, nature, and its practice complexity (**AICPA, 2009**). The audit firm's quality-control procedures should be developed for each of the following functions (**Healy & Palepu, 2003**):



### 8.2.2.1 *Leadership Responsibilities for Quality Within the Firm*

Audit firms' internal operating systems should be able to complete engagements in accordance with professional standards and local regulations (ICAA, 2005). A peer-review approach should be targeted to support audit firms' standards implementation, and impose corrective actions to rectify any internal deficiencies.

### 8.2.2.2 *Ethical Requirements*

Local audit firms should establish proper policies and procedures that provide them with reasonable assurance regarding personnel complying with relevant ethical requirements.

### 8.2.2.3 *Acceptance and Continuation of Clients' Relationships and Specific Engagements*

Audit firms' internal policies for new clients' acceptance and re-engagement should be properly set up, in order to ascertain firms' independency before accepting any assignment. Audit firms must only accept or continue engagements where:

- It is convinced of the client's integrity;
- The firm has the capabilities, time, and resources to complete the assignment; and
- The firm can comply with ethical standards requirements.

### 8.2.2.4 *Human Resources*

Audit firms' internal policies should be able to provide sufficient information about staff capabilities and competences to complete assignments as per professional standards.

### 8.2.2.5 *Monitoring*

Audit firms' monitoring procedures should be capable of controlling the audit assignments' operating quality, such as policies and procedures that include an ongoing consideration of evaluation, and periodic inspection of quality control.

## 8.2.3 **General Conclusion**

The magnitude of each variable in the practicing environment will be differentiated from one country to another based on the local culture and influence power of environment different variables. Accordingly, categorizing of environmental factors into groups

for similar countries will be more efficient and save efforts during the study phase and implementation of audit harmonization.

Since Egypt is applying the Roman law system, any proposed practicing reforms require detailed laws to be issued by parliament to codify each type of accounting transactions, mainly if we consider the Egyptian basic values culture classification that has a low score of uncertainty avoidance and power distance.

The current Egyptian local practice environment is classified as a dormant, complex, and uncertain environment that needs major reforms in order to increase its practice organizations' effectiveness. The Egyptian practice environment encourages the reduction of accounting and auditing profession's judgment role.

Also, empirical research results raised a consensus between the selected sample answers about the importance of increasing professional accountants and auditors' technical and judgmental capability, in addition to the necessity of increasing the non-governmental organizations' subscriptions in developing and managing the practicing profession.

The causes beyond the research results may be associated with the increase of globalization phenomena, and the influence of international audit-practicing environment on the way that the local Egyptian practice environment interacts.

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**General Appendices**



## General Appendices

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### General Information

- 1- Name (Optional): ..... Telephone No.: .....
- 2- Qualification (Highest Qualification): ..... 3- Graduation Year: .....
- 4- Professional Certification: (Please tick ✓ and mention the graduation year)
- CPA  CIA  CA  ACCA  Other (Please specify) .....
- 6- Current Job: .....
- Governmental  Employee in a private auditing office  CAPMAS  
 Professional Firm Owner  Other .....
- 7- Work Field:
- Insurance  Taxing  Costs  General Accounting  Auditing  
 Other (Please specify) .....
- 8- How do you evaluate your professional performance?
- Excellent  Good  Average  Bad
- 9- To what extent do you think the following problems exist and affect the auditing practicing in the current practicing environment:-

	Exists	Does not exist	To a certain extent
a- The lack of auditing standards	----	----	----
b- Defects in some of the applied auditing standards	----	----	----
c- The Profession Practicing Law and its regulating rules are outdated.	----	----	----
d- The auditor's limited responsibility towards the beneficiary	----	----	----
e- Easiness of obtaining the practicing license.	----	----	----
f- Inconveniency of auditing environment	----	----	----
g- The limited role of the authorities regulating accounting and auditing practicings	----	----	----

10- From your point of view, which of the following factors have more effect on the auditing environment?

**a- Laws and Procedures:**

- |  |                                      |
|--|--------------------------------------|
| 1- The efficiency of the professional organization procedure       | <u>Proposed arrangement</u><br>..... |
| 2- The laws regulating the auditing process and the auditor's role | .....                                |

**b- Organisations:**

- |  |       |
|--|-------|
| 1- Non governmental professional organisations regulating the auditing practicing  | ..... |
| 2- The supervisory governmental organisations controlling auditing practicing      | ..... |
| 3- Non governmental international organisations regulating the auditing practicing | ..... |

**c- Standards:**

- |  |       |
|--|-------|
| 1- International auditing standards          | ..... |
| 2- International financial reports standards | ..... |

## General Appendices

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### First Part

#### The effect of non governmental professional associations on the auditing environment

##### (1) Questions related to the professional associations:-

Questions	Strongly agree	Agree	Agree to some extent	Do not agree	Strongly do not agree
1- The effect of non governmental professional associations is one of the factors influencing the auditing environment.					
2- The membership of professional associations must be a requirement for obtaining the practicing license.					
3- Do you believe in the role of professional associations in developing the auditing profession?					
4- Do you believe in the necessity of activating the professional associations' role to be the main supervisory authority controlling the application of professional requirements?					
5- Do you think that the supervision of the role and performance of professional associations must be carried out by a governmental authority?					
6- Does the Profession Practicing Law need to be ruled by the powers and responsibilities of the professional associations?					
7- The dependency of the professional associations to the governmental legislative authority increases the efficiency of its role affecting the auditing environment.					
8- The professional associations have more effective role on the auditing process than the government authorities regulating the company's operations.					
9- Dealing with the international professional authorities "IAS Board, IFAC" should be carried out through the professional associations not the governmental organisations related to auditing.					
10- The standardization of dealing with the professional associations as a main authority regulating auditing offices and auditors will increase the efficiency and performance of the auditing practicing.					

## General Appendices

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### Second Part

#### The effect of the professional organisations practicing auditing on the auditing environment

Question	Strongly agree	Agree	Agree to some extent	Do not agree	Strongly do not agree
1- The mutual understanding between the customers and the professional organisations on the provided services helps improving the performance of auditing practicing environment.					
2- The availability of a system for evaluating the efficiency and quality of the relation with the customer has a limited effect on the auditing practicing environment.					
3- The planning for the control arrangements of applying the professional quality in a way that meets the organisational requirements and technical standards helps improving the performance of auditing practicing environment.					
4- The auditor's awareness of the customer's work field and activities has a limited effect on the auditing practicing environment.					
5- Keeping the auditors up to date with the changes of the professional requirements (accounting standards, independency, objectivity, policies and procedures) helps activate the auditing practicing environment.					
6- The availability of internal rules at the professional organisations guarantying the regular change of auditors helps improve the auditing practicing environment.					
7- The organisations' use of an effective mechanism to face the failure in the application of quality procedures and policies helps improve the auditing practicing environment.					
8- Do you think the professional organisations working in the auditing field are some of the factors influencing the auditing practicing environment?					

## General Appendices

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### Third part

#### The effect of the governmental authorities and laws on the auditing practicing environment

##### (1) General questions:

Question	Strongly agree	Agree	Agree to some extent	Do not agree	Strongly do not agree
1- Do you think the role of the governmental authorities, laws, financial and professional regulations are some of the factors affecting the auditing practicing environment?					
2- Do you think that the amendment of the professional laws and regulations has less effect on the auditing practicing environment than the professional associations' role?					
3- Do you think that the amendment of the laws regulating the companies' work through clearer definition of the Board role and practicing morals will positively affect the auditing practicing environment?					
4- Do you think the selection, appointment and termination of the services of auditor by the General Assembly through the company's internal auditing committee will help increase the efficiency of the auditing profession environment through the auditor's independency?					
5- Do you think that the non governmental authorities related to the auditing profession must have a role in formulating the laws affecting the auditing profession environment (companies' laws, commercial laws, stock market laws, and auditing practicing laws) which helps increase the efficiency of the laws and improves the auditing practicing environment?					
6- The role of setting the accounting standards and the supervision of the professional offices should be carried out through the governmental authorities related to auditing.					
7- The mutual cooperation between the governmental authorities and professional associations in organising the auditing profession will help improve the performance of the auditing environment.					

## General Appendices

### **(B) Questions on the law regulating the practice of auditing profession:**

Question	Strongly agree	Agree	Agree to some extent	Do not agree	Strongly do not agree
1- The inclusion of rules determining the auditor's fees in the auditing practice law will positively affect the auditing practicing environment.					
2- The inclusion of restrictions on the financial relation between the auditor and the customer in the auditing practice law will positively affect the auditing practicing environment.					
3- The inclusion of the auditor's rights and duties as per the international standards in the auditing practice law will positively affect the auditing practicing environment.					
4- The modification of all types of services provided by auditing offices in the auditing practice law will positively affect the auditing practicing environment.					
5- The amendment of the auditing practice law to include only the services related to obligatory annual auditing will positively affect the auditing practicing environment.					
6- The inclusion of the conditions and rules of the auditors' continuing learning in the auditing practice law will positively affect the auditing practicing environment.					
7- The inclusion of the condition of passing a test after completing the professional program as a requirement for obtaining the license in the auditing practice law will positively affect the auditing practicing environment.					
8- The inclusion of the condition of having a relative previous experience for obtaining the license in the auditing practice law will positively affect the auditing practicing environment.					
9- Allowing the non certified auditors to own 49% of the auditing offices will positively affect the auditing practicing environment.					
10- The amendment of the profession laws to include the necessity of applying the international auditing standards will positively affect the auditing practicing environment.					
11- The inclusion of Code of ethics in the auditing practice law will positively affect the auditing practicing environment.					
12- The inclusion of the powers and responsibilities of the Professional Associations and their control on the auditing offices and members in the auditing practice law will have a limited effect on the auditing profession environment.					
13- The inclusion of the authorities authorized to deal with international professional auditing and accounting associations in the auditing practice law will positively affect the auditing practicing environment.					
14- The inclusion of a mechanism to regulate the relations between the governmental and non governmental authorities ruling this profession and the auditing offices and auditors in the auditing practice law will positively affect the auditing practicing environment.					

## General Appendices

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### Forth Part The effect of the auditors' qualification on the auditing practicing environment

Question	Strongly agree	Agree	Agree to some extent	Do not agree	Strongly do not agree
1- Do you think that the application of continuing vocational education will be more effective if carried out through obligatory instructions from the professional associations regulating the auditing profession?					
2- Do you think that the professionalism of the auditor is one of the factors affecting the auditing practicing environment?					
3- Assigning the professional associations to supervise the auditor's commitment to the continuing education requirements will have more effect on the auditing practicing environment rather than assigning the governmental authorities to this job.					
4- Determining the auditor's annual duties should be based on the vocational training previously received.					
5- The commitment to Code of Ethics plays a more effective role in improving the auditing practicing environment than the laws regulating profession practice and companies work.					

## General Appendices

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### **Fifth Part** **The effect of the interested parties on the auditing practicing environment**

Question	Strongly agree	Agree	Agree to some extent	Do not agree	Strongly do not agree
1- Do you think that the interested parties and beneficiaries (Stock companies managements, banks, governmental and supervisory authorities) are some of the factors affecting the auditing practicing environment?					
2- Do you think that the main interest of the beneficiaries is to obtain the financial statements, information summary and the financial policies rather than obtaining efficient recommendations or realizing the scope of work and procedures applied by the professional authorities?					
3- Do you think that the companies' managements growing awareness of their social responsibilities helps increasing the performance and efficiency of the auditing practicing environment?					
4- The meeting of the beneficiaries' unusual requirements is one of the auditing priorities.					
5- The beneficiaries' continuing interest in following up the auditing procedures provided by the professional authorities and the verification of these authorities' recommendations will help improving the auditing practicing environment.					
6- The management philosophy and operating way may affect the auditing practicing environment.					
7- Obliging the commercial organisations by the governmental supervisory authorities to apply the code of ethics through the business ethics laws and the auditing committees' duties strongly affects the auditing practicing environment.					

## General Appendices

### بيانات عامة

- 1- الإسم (اختياري): .....
- 2- المؤهل (آخر مؤهل): .....
- 3- سنة التخرج : .....
- 4- الشهادات المهنية: (ضع علامة ✓ وسنة التخرج)
- CPA  CIA  CA  ACCA  أخرى (تذكر)
- .....
- 6- العمل الحالي: .....
- حكومي.  صاحب مؤسسة مهنية.  موظف بمكتب مراجعة خاص.  الجهاز المركزي للمحاسبة.  أخرى .....
- 7- مجال العمل:
- التأمين  الضرائب  التكاليف  المحاسبة العامة  المراجعة  أخرى (تذكر) .....
- 8- كيف تقيم أداءك المهني ؟  ممتاز  جيد  عادي  سيئ
- 9- إلى أي حد ترى أن المشكلات التالية موجودة ومؤثرة على ممارسة المهنة من خلال بيئة العمل الحالية:-
- | موجود | غير موجود | إلى حد ما |
|-------|-----------|-----------|
| ----  | ----      | ----      |
| ----  | ----      | ----      |
| ----  | ----      | ----      |
| ----  | ----      | ----      |
| ----  | ----      | ----      |
| ----  | ----      | ----      |
| ----  | ----      | ----      |
| ----  | ----      | ----      |
- أ- نقص معايير المراجعة.
- ب- عيوب في بعض معايير المراجعة المطبقة.
- ت- تقادم قانون مزاوله المهنة وقواعد تنظيمها.
- ث- محدودية مسئولية المراجع تجاه المستفيد من الخدمة.
- ج- سهولة الحصول على ترخيص المزاوله.
- ح- عدم ملائمة بيئة المراجعة.
- خ- محدودية دور الجهات المنظمة لأعمال المحاسبة والمراجعة.
- 10- أي من العوامل الآتية من وجهة نظرك الأكثر تأثيراً على بيئة الأداء لعملية المراجعة:
- أ- الإجراءات والقوانين:
- 1- كفاءة الإجراءات في المؤسسة المهنية
- 2- القوانين المنظمة لعملية المراجعة ودور المراجع
- ب- المؤسسات:
- 1- المؤسسات المهنية غير الحكومية المنظمة لأعمال مهنة المراجعة
- 2- المؤسسات الحكومية الرقابية التي تشرف على أعمال المراجعة
- 3- المؤسسات الدولية غير الحكومية المنظمة لأعمال مهنة المراجعة
- ج- المعايير:
- 1- معايير المراجعة الدولية
- 2- معايير التقارير المالية الدولية
- .....



## General Appendices

### الجزء الأول

#### قياس تأثير الجمعيات المهنية غير الحكومية على بيئة عمل مهنة المراجعة

##### (أ) أسئلة خاصة بالجمعيات المهنية:-

السؤال	أوافق بشدة	أوافق	أوافق إلى حد ما	لا أوافق بشدة	لا أوافق
1. أن تأثير الجمعيات المهنية غير الحكومية يعتبر أحد العوامل المؤثرة في بيئة عمل مهنة المراجعة.					
2. يجب أن تكون عضوية الجمعيات المهنية شرطاً للحصول على ترخيص المزاولة.					
3. هل تعتقد بأهمية الدور الفعال للجمعيات المهنية في تطوير أداء المهنة.					
4. هل تعتقد بضرورة تفعيل دور الجمعيات المهنية لتصبح أداة الإشراف والرقابة الأساسية على تطبيق المتطلبات المهنية للمزاولة.					
5. هل تعتقد أن الإشراف على أداء ودور الجمعيات المهنية يجب أن يتم من قبل أحد الجهات الحكومية.					
6. هل يجب أن ينظم قانون مزاولة المهنة من خلال دور وساطات ومسئوليات الجمعيات المهنية.					
7. أن تبعية الجمعيات المهنية للسلطة التشريعية بالدولة يزيد من فعالية دورها المؤثر في بيئة عمل مهنة المراجعة.					
8. أن دور الجمعيات المهنية يعتبر أكثر تأثيراً على أداء عملية المراجعة من الجهات الحكومية التي تنظم عمل الشركات وتلك الخاصة بمزاولة المهنة.					
9. أن التعامل مع الجهات المهنية الدولية "IAS Board, IFAC" يجب أن يتم من خلال الجمعيات المهنية وليس المؤسسات الحكومية ذات العلاقة بمهنة المراجعة.					
10. أن توحيد التعامل مع الجمعيات المهنية كمظلة أساسية يندرج تحتها مكاتب المراجعة ومزاولي المهنة سوف يزيد من فعالية وكفاءة بيئة عمل مهنة المراجعة.					

## General Appendices

### الجزء الثاني

#### قياس تأثير أداء المؤسسات المهنية المزاولة على بيئة عمل مهنة المراجعة

السؤال	أوافق بشدة	أوافق	أوافق إلى حد ما	لا أوافق بشدة	لا أوافق
1. أن وجود تفاهم متبادل بين العملاء والمؤسسات المهنية حول الخدمة المقدمة يساهم في تحسين أداء بيئة عمل مهنة المراجعة.					
2. أن توافر نظاماً لتقييم كفاءة وجودة العلاقة مع العميل يعتبر ذو تأثير محدود على أداء بيئة عمل مهنة المراجعة.					
3. أن التخطيط لترتيبات رقابة الجودة المهنية المطبقة بشكل يلبي المتطلبات المهنية والتنظيمية والمعايير الفنية يساعد في تحسين بيئة عمل مهنة المراجعة.					
4. أن معرفة المراجع بمجال عمل العميل وأنشطته يعتبر تأثيره محدود على بيئة عمل مهنة المراجعة.					
5. أن إبلاغ المراجعين بصفة دورية بالتعديلات في المتطلبات المهنية (معايير المحاسبة والمراجعة ، الاستقلالية ، الموضوعية ، السياسات والإجراءات) يساهم في تفعيل بيئة عمل مهنة المراجعة.					
6. أن وجود قواعد داخلية بالمؤسسات المهنية تكفل تغيير المراجعين المسؤولين عن العمليات المنفذة بصورة دورية يساعد على تحسين بيئة عمل مهنة المراجعة.					
7. أن تطبيق المؤسسات المهنية لآلية فعالة لمواجهة حالات الفشل في تطبيق سياسة أو إجراءات الجودة سوف يساعد في تحسين أداء المؤسسة المهني.					
8. هل تعتقد بأن المؤسسات المهنية العاملة بمجال المراجعة تعتبر أحد العوامل المؤثرة في بيئة عمل مهنة المراجعة.					

## General Appendices

### الجزء الثالث

#### قياس تأثير الجهات الحكومية والقوانين على بيئة عمل مهنة المراجعة

(أ) أسئلة عامة:

السؤال	أوافق بشدة	أوافق	أوافق إلى حد ما	لا أوافق بشدة	لا أوافق
1. هل تعتقد بأن دور الجهات الحكومية والقوانين والتشريعات المالية والمهنية يعتبر من أهم العوامل المؤثرة على بيئة عمل مهنة المراجعة.					
2. هل تعتقد بأن تعديل القوانين والقواعد المهنية يعتبر أقل أثراً على بيئة عمل مهنة المراجعة من الدور الذي تلعبه الجمعيات المهنية.					
3. هل تعتقد بأن تعديل القوانين المنظمة لعمل الشركات من خلال التحديد الأكثر وضوحاً لدور مجلس الإدارة وأخلاقيات ممارسته لعمله سوف يؤثر إيجابياً على بيئة عمل مهنة المراجعة.					
4. هل تعتقد بأن إسناد مهمة اختيار مراجع الحسابات والتوصية بتعيينه أو إنهاء أعماله إلى الجمعية العامة من خلال لجنة المراجعة بالشركة سوف يساعد في تفعيل كفاءة بيئة عمل مهنة المراجعة من خلال زيادة استقلالية المراجع.					
5. هل تعتقد بأن الجهات غير الحكومية ذات العلاقة بمهنة المراجعة يجب أن يكون لها دور في صياغة أي من القوانين المؤثرة على أداء بيئة عمل مهنة المراجعة (مثل قوانين الشركات ، القوانين التجارية ، قوانين سوق المال ، وقوانين مزاوله مهنة المراجعة) مما يساعد على زيادة كفاءة القوانين ويحسن البيئة العامة لأداء عملية المراجعة.					
6. أن دور وضع معايير المحاسبة والإشراف على أعمال المكاتب المهنية يجب أن يتم من خلال الجهات الحكومية ذات العلاقة بعملية المراجعة.					
7. أن وجود تعاون مشترك بين الجمعيات المهنية والجهات الحكومية في تنظيم عمل مهنة المراجعة سوف يساعد على تحسين أداء بيئة عمل مهنة المراجعة.					

## General Appendices

### (ب) أسئلة خاصة بالقانون المنظم لممارسة المهنة:

لا أوافق بشدة	لا أوافق	أوافق إلى حد ما	أوافق	أوافق بشدة	السؤال
					1. أن تضمين قانون ممارسة المهنة لقواعد تنظم تحديد الأتعاب المهنية للمراجع سوف يؤثر إيجابياً على بيئة عمل مهنة المراجعة.
					2. أن تضمين قانون ممارسة المهنة قيوداً على العلاقة المالية بين المراجع والعميل سوف يؤثر إيجابياً على بيئة عمل مهنة المراجعة.
					3. أن تضمين قانون ممارسة المهنة على حقوق والتزامات المراجع وبما يتناسب مع المطبق عالمياً سوف يؤثر إيجابياً على بيئة عمل مهنة المراجعة.
					4. أن تعديل قانون مزاولة المهنة كافة أنواع الخدمات المهنية المقدمة من مكاتب المراجعة سوف يؤثر إيجابياً على بيئة عمل مهنة المراجعة.
					5. أن تعديل قانون مزاولة المهنة ليشمل فقط الخدمات الخاصة بالمراجعة الإلزامية السنوية سوف يؤثر إيجابياً على بيئة عمل مهنة المراجعة.
					6. أن تضمين قانون مزاولة المهنة شروط وأحكام خاصة بالتعليم المستمر لمزاولي المهنة سوف يؤثر إيجابياً على بيئة عمل مهنة المراجعة.
					7. أن تضمين قانون مزاولة المهنة شرط اجتياز اختبار يجري بعد انتهاء برنامج مهني مخصص لذلك ، كأحد المتطلبات الرئيسية للحصول على ترخيص بمزاولة مهنة المراجعة سوف يؤثر إيجابياً على بيئة عمل مهنة المراجعة.
					8. أن تضمين القانون المنظم لمزاولة المهنة على شرط توفر خبرة مهنية سابقة لمزاولة المهنة قبل الحصول على ترخيص للمزاولة سوف يؤثر إيجابياً على بيئة عمل مهنة المراجعة.
					9. أن السماح لقانون مزاولة المهنة لغير المراجعين المرخصين بامتلاك 49% من مكاتب المراجعة سوف يؤثر إيجابياً على بيئة عمل مهنة المراجعة.
					10. أن تعديل القوانين المنظمة لأداء المهنة بحيث تشتمل على ضرورة الالتزام بتطبيق معايير المراجعة الدولية سوف يؤثر إيجابياً على بيئة عمل مهنة المراجعة.
					11. أن تضمين قانون مزاولة المهنة الكود الخاص بأخلاقيات المهنة Code of ethics سوف يؤثر إيجابياً على بيئة عمل مهنة المراجعة.
					12. أن تضمين قانون مزاولة المهنة تحديد واضح للسلطات ومسئوليات الجهات غير الحكومية المنظمة لعمل المهنة "Professional Associations" من حيث إشرافها على أعمال مكاتب المراجعة وأعضائها له تأثير محدود على بيئة عمل مهنة المراجعة.
					13. أن تضمين قانون مزاولة المهنة تحديداً للجهات المخولة بالتعامل مع الجمعيات المهنية العالمية المنظمة لعملية المحاسبة والمراجعة "IFRS Board & IFAC" سوف يؤثر إيجابياً على بيئة عمل مهنة المراجعة.
					14. أن تضمين قانون مزاولة المهنة آلية تنظم العلاقة بين الجهات الحكومية وغير الحكومية المنظمة لعمل المهنة وكل من مكاتب المراجعة والمراجعين المزاولين سوف يؤثر إيجابياً على بيئة عمل مهنة المراجعة.

## General Appendices

### (ج) أسئلة خاصة بالقوانين المنظمة لعمل الشركات:

لا أوافق بشدة	لا أوافق	أوافق إلى حد ما	أوافق	أوافق بشدة	السؤال
					1. أن تضمن القوانين المنظمة لعمل الشركات ما يضمن استقلالية المراجع سوف يؤثر إيجابياً على بيئة عمل مهنة المراجعة.
					2. أن تضمن القوانين المنظمة لعمل الشركات إلزاماً للمراجع بتوضيح حجم الأموال التي حصل عليها من العميل عن خدماته الأخرى بخلاف المراجعة سوف يؤثر إيجابياً على بيئة عمل مهنة المراجعة.
					3. أن تضمن القوانين المنظمة لعمل الشركات آلية تلزم الشركات بتغيير المراجع بعد فترة زمنية محددة (5 سنوات مثلاً) سوف يؤثر إيجابياً على بيئة عمل مهنة المراجعة.
					4. أن تعديل القوانين المنظمة لعمل الشركات بحيث تشتمل على ضرورة التزام الشركات بتطبيق معايير المحاسبة الدولية سوف يؤثر إيجابياً على بيئة عمل مهنة المراجعة.
					5. أن تعديل القوانين المنظمة لعمل الشركات بحيث تشتمل على تشريع يتعلق بأخلاقيات مزاوله إدارة الشركات ومساهمتها لنشاطها "Code of ethics" سوف يؤثر إيجابياً على بيئة عمل مهنة المراجعة.

### الجزء الرابع

#### قياس تأثير تأهيل المراجعين على بيئة عمل مهنة المراجعة

لا أوافق بشدة	لا أوافق	أوافق إلى حد ما	أوافق	أوافق بشدة	السؤال
					1. هل تعتقد بأن تطبيق نظام التعليم المهني المستمر سوف يكون أكثر فعالية إذا ما تم من خلال إصدار توجيهات إلزامية من الجمعيات المهنية المنظمة لمزاوله المهنة.
					2. هل تعتقد أن درجة مهنية مراجع الحسابات تعتبر أحد العوامل المؤثرة في بيئة عمل مهنة المراجعة.
					3. أن إسناد مهمة الرقابة على مدى التزام المراجع بمتطلبات التعليم المستمر إلى الجمعيات المهنية سوف يكون تأثيره أكثر فعالية على تحسين بيئة عمل مهنة المراجعة من إسناد هذه المهمة إلى الجهات الحكومية.
					4. أن تحديد المهام التي يكلف بها المراجع خلال السنة يجب أن يتم على أساس التدريب المهني الذي تلقاه خلال الفترات السابقة.
					5. أن الالتزام بتطبيق أخلاقيات المهنة يلعب دور أكثر تأثيراً في تحسين بيئة عمل مهنة المراجعة عن تلك القوانين المنظمة لممارسة المهنة وتلك المنظمة لعمل الشركات.

### الجزء الخامس

#### قياس تأثير أصحاب المصالح على بيئة عمل مهنة المراجعة

## General Appendices

السؤال	أوافق بشدة	أوافق	أوافق إلى حد ما	لا أوافق بشدة	لا أوافق بشدة
1. هل تعتقد أن أصحاب المصالح والمستفيدين من خدمة المراجعة (على سبيل المثال إدارات الشركات المساهمة ، البنوك ، الجهات الحكومية والرقابية وغيرها) يعتبروا من أحد العوامل الهامة المؤثرة على بيئة عمل مهنة المراجعة.					
2. هل تعتقد أن الاهتمام الأساسي لأصحاب المصالح يتمثل في الحصول على القوائم المالية وملخص المعلومات والسياسات المالية دون الاهتمام بالحصول على توصيات فعالة من خلال عملية المراجعة أو معرفة نطاق العمل والإجراءات المطبقة من الجهات المهنية.					
3. هل تعتقد أن زيادة الوعي لدى إدارات الشركات بدورها الاجتماعي يساعد على زيادة فعالية وكفاءة بيئة عمل مهنة المراجعة.					
4. أن تلبية المتطلبات غير الاعتيادية لأصحاب المصالح من أولويات مهنة المراجعة.					
5. أن وجود اهتمام مستمر من أصحاب المصالح بمتابعة ملاحظات المراجعة المقدمة من الجهات المهنية والتحقق من تطبيق توصيات هذه الجهات سوف يساعد في تحسين بيئة عمل مهنة المراجعة.					
6. أن فلسفة الإدارة وأسلوبها في التشغيل قد تؤثر على بيئة عمل مهنة المراجعة بشكل كبير.					
7. أن إلزام الجهات الإشرافية الحكومية للمنظمات التجارية بتطبيق أخلاقيات العمل التجاري من خلال قوانين تنظم أخلاقيات ومبادئ العمل التجاري ومهام لجان المراجعة والرقابة على أخلاقيات العمل التجاري يؤثر بدرجة كبيرة على بيئة عمل مهنة المراجعة.					

## General Appendices

### الجزء السادس

#### تأثير قياس الجمعيات المهنية الدولية على بيئة عمل مهنة المراجعة

لا أوافق بشدة	لا أوافق	أوافق إلى حد ما	أوافق	أوافق بشدة	السؤال
					1. أن معايير المراجعة الدولية تلعب دوراً أساسياً في التأثير على إجراءات المراجعة والخدمات المهنية المقدمة في البيئة المحلية المنظمة لأداء أعمال المراجعة.
					2. أن الالتزام بتطبيق معايير المحاسبة الدولية يؤثر بدرجة إيجابية كبيرة على البيئة المحلية المنظمة لأداء أعمال المراجعة.
					3. أن التنسيق بين المؤسسات المهنية الدولية وتلك المقابلة لها على المستوى المحلي يزيد من كفاءة وفعالية أداء المؤسسات المحلية.
					4. أن الالتزام بمعايير الأداء المهنية الصادرة من المؤسسات المهنية الدولية على المستوى المحلي يزيد من ثقة أصحاب المصلحة في أداء بيئة عمل مهنة المراجعة.
					5. هل تعتقد أن المؤسسات المهنية الدولية المهنية مثال ( IFAC, IPAC, FOSCO ) لديها تأثير كبير على أداء البيئة المحلية المنظمة لعمل مهنة المراجعة.
					6. هل تعتقد أن هناك توافق بين أهداف المؤسسات المهنية الدولية وتلك المقابلة لها على المستوى المحلي.
					7. هل تعتقد أن التشريعات والقوانين المحلية يجب أن تأخذ في الاعتبار متطلبات المؤسسات المهنية العالمية.





## General Appendices

REGRESSION /MISSING LISTWISE /STATISTICS COEFF OUTS R ANOVA /CRITERIA=PIN(.10)

### Regression

#### Notes

Output Created Comments Input  Active Dataset Filter Weight Split File N of Rows in Working Data File Missing Value Handling Definition of Missing Cases Used  Syntax  Resources Processor Time Elapsed Time Memory Required Additional Memory Required for Residual Plots	21-2010-ماي AST 15:17:34  C:\Users\sersy\Desktop\Imparical Part\Data.sav DataSet1 <none> <none> <none> 105 User-defined missing values are treated as missing. Statistics are based on cases with no missing values for any variable used. REGRESSION /MISSING LISTWISE /STATISTICS COEFF OUTS R ANOVA /CRITERIA=PIN(.05) POUT(.10) /NOORIGIN /DEPENDENT q10_a1 /METHOD=ENTER q9_1 q9_2 q9_3 q9_4 q9_5 q9_6 q9_7. 0:00:00.047 0:00:00.084 5620 bytes 0 bytes
---	--

[DataSet1] C:\Users\sersy\Desktop\Imparical Part\Data.sav

#### Variables Entered/Removed

Model	Variables Entered	Variables Removed	Method
1	q9_7, q9_3, q9_5, q9_4, q9_2, q9_6, q9_1 <sup>a</sup>		Enter

a. All requested variables entered.

#### Model Summary

## General Appendices

Model	R	R Square	Adjusted R Square
1	.342 <sup>a</sup>	.117	.042

a. Predictors: (Constant), q9\_7, q9\_3, q9\_5, q9\_4, q9\_2, q9\_6, q9\_1

### ANOVA<sup>b</sup>

Model		Sum of Squares	df
1	Regression	21.032	7
	Residual	158.624	82
	Total	179.656	89

a. Predictors: (Constant), q9\_7, q9\_3, q9\_5, q9\_4, q9\_2, q9\_6, q9\_1

b. Dependent Variable: q10\_a1

### Coefficients<sup>a</sup>

Model		Unstandardized Coefficients	
		B	Std. Error
1	(Constant)	1.223	.736
	q9_1	-.081	.217
	q9_2	.174	.189
	q9_3	-.161	.192
	q9_4	.183	.184
	q9_5	.066	.188
	q9_6	.361	.176
	q9_7	-.084	.158

a. Dependent Variable: q10\_a1

```
05) POUT(.10) /NOORIGIN /DEPENDENT q10_a1 /METHOD=ENTER q9_1 q9_2 q9_3 q9_4
```

## General Appendices

---

Std. Error of the Estimate
1.391

Mean Square	F	Sig.
3.005	1.553	.161 <sup>a</sup>
1.934		

Standardized Coefficients		
Beta	t	Sig.
	1.662	.100
-.045	-.375	.708
.104	.923	.359
-.097	-.834	.406
.115	.993	.324
.038	.353	.725
.234	2.053	.043
-.056	-.528	.599

## General Appendices

4 q9\_5 q9\_6 q9\_7.

REGRESSION /MISSING LISTWISE /STATISTICS COEFF OUTS R ANOVA /CRITERIA=PIN(.05) POUT(.10) /NOORIGIN /DEPENDENT q10\_a2 /METHOD=ENTER q9\_1 q9\_2 q9\_3 q9\_4 q9\_5 q9\_6 q9\_7.

### Regression

#### Notes

Output Created	21-2010-ماي AST 15:22:05	
Comments		
Input	Data	C:\Users\sersy\Desktop\Imparical Part\Data.sav
	Active Dataset	DataSet1
	Filter	<none>
	Weight	<none>
	Split File	<none>
	N of Rows in Working Data File	105
Missing Value Handling	Definition of Missing	User-defined missing values are treated as missing.
	Cases Used	Statistics are based on cases with no missing values for any variable used.
Syntax	REGRESSION /MISSING LISTWISE /STATISTICS COEFF OUTS R ANOVA /CRITERIA=PIN(.05) POUT(.10) /NOORIGIN /DEPENDENT q10_a2 /METHOD=ENTER q9_1 q9_2 q9_3 q9_4 q9_5 q9_6 q9_7.	
Resources	Processor Time	0:00:00.062
	Elapsed Time	0:00:00.104
	Memory Required	5620 bytes
	Additional Memory Required for Residual Plots	0 bytes

[DataSet1] C:\Users\sersy\Desktop\Imparical Part\Data.sav

#### Variables Entered/Removed

Model	Variables Entered	Variables Removed	Method
1	q9_7, q9_1, q9_2, q9_5, q9_4, q9_6, q9_3 <sup>a</sup>		Enter

a. All requested variables entered.

#### Model Summary

## General Appendices

Model	R	R Square	Adjusted R Square
1	.279 <sup>a</sup>	.078	.000

a. Predictors: (Constant), q9\_7, q9\_1, q9\_2, q9\_5, q9\_4, q9\_6, q9\_3

### ANOVA<sup>b</sup>

Model		Sum of Squares	df
1	Regression	9.982	7
	Residual	118.699	83
	Total	128.681	90

a. Predictors: (Constant), q9\_7, q9\_1, q9\_2, q9\_5, q9\_4, q9\_6, q9\_3

b. Dependent Variable: q10\_a2

### Coefficients<sup>a</sup>

Model		Unstandardized Coefficients	
		B	Std. Error
1	(Constant)	1.445	.631
	q9_1	.061	.188
	q9_2	-.016	.159
	q9_3	.187	.166
	q9_4	.148	.155
	q9_5	-.285	.163
	q9_6	.129	.149
	q9_7	-.067	.136

a. Dependent Variable: q10\_a2

```
05) POUT(.10) /NOORIGIN /DEPENDENT q10_a2 /METHOD=ENTER q9_1 q9_2 q9_3 q9_4
```

## General Appendices

---

Std. Error of the Estimate
1.196

Mean Square	F	Sig.
1.426	.997	.439 <sup>a</sup>
1.430		

Standardized Coefficients		
Beta	t	Sig.
	2.289	.025
.040	.326	.745
-.011	-.098	.922
.132	1.128	.263
.110	.953	.343
-.195	-1.751	.084
.101	.865	.389
-.054	-.493	.623

## General Appendices

4 q9\_5 q9\_6 q9\_7.

```
REGRESSION /MISSING LISTWISE /STATISTICS COEFF OUTS R ANOVA /CRITERIA=PIN(.05)
POUT(.10) /NOORIGIN /DEPENDENT q10_c1 /METHOD=ENTER q9_1 q9_2 q9_3 q9_4 q9_5 q9_6
q9_7.
```

### Regression

Notes	
Output Created	21-2010-ماي AST 15:25:08
Comments	
Input	C:\Users\sersy\Desktop\Imparical Part\Data.sav
	DataSet1
	Filter <none>
	Weight <none>
	Split File <none>
	N of Rows in Working Data File 105
Missing Value Handling	Definition of Missing User-defined missing values are treated as missing.
	Cases Used Statistics are based on cases with no missing values for any variable used.
Syntax	REGRESSION /MISSING LISTWISE /STATISTICS COEFF OUTS R ANOVA /CRITERIA=PIN(.05) POUT(.10) /NOORIGIN /DEPENDENT q10_c1 /METHOD=ENTER q9_1 q9_2 q9_3 q9_4 q9_5 q9_6 q9_7.
Resources	Processor Time 0:00:00.032
	Elapsed Time 0:00:00.068
	Memory Required 5620 bytes
	Additional Memory Required for Residual Plots 0 bytes

[DataSet1] C:\Users\sersy\Desktop\Imparical Part\Data.sav

#### Variables Entered/Removed

Model	Variables Entered	Variables Removed	Method
1	q9_7, q9_1, q9_2, q9_5, q9_4, q9_3, q9_6 <sup>a</sup>		Enter

a. All requested variables entered.

#### Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.329 <sup>a</sup>	.108	.029	1.498

a. Predictors: (Constant), q9\_7, q9\_1, q9\_2, q9\_5, q9\_4, q9\_3, q9\_6

#### ANOVA<sup>b</sup>

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	21.481	7	3.069	1.367	.231 <sup>a</sup>
	Residual	177.370	79	2.245		
	Total	198.851	86			

a. Predictors: (Constant), q9\_7, q9\_1, q9\_2, q9\_5, q9\_4, q9\_3, q9\_6

b. Dependent Variable: q10\_c1

#### Coefficients<sup>a</sup>

		Unstandardized Coefficients	Standardized Coefficients

## General Appendices

Model		B	Std. Error	Beta	t	Sig.
1	(Constant)	.401	.797		.503	.616
	q9_1	.086	.240	.044	.359	.721
	q9_2	.160	.208	.089	.772	.442
	q9_3	.466	.214	.259	2.177	.032
	q9_4	.104	.197	.062	.528	.599
	q9_5	.160	.207	.086	.777	.440
	q9_6	.123	.195	.075	.630	.530
	q9_7	-.121	.173	-.077	-.699	.487

a. Dependent Variable: q10\_c1

```
REGRESSION /MISSING LISTWISE /STATISTICS COEFF OUTS R ANOVA /CRITERIA=PIN(.05)
POUT(.10) /NOORIGIN /DEPENDENT q10_c2 /METHOD=ENTER q9_1 q9_2 q9_3 q9_4 q9_5 q9_6
q9_7.
```

### Regression

Notes		
Output Created		21-2010.g4 AST 15:25:47
Comments		
Input	Data	C:\Users\sersy\Desktop\Imparical Part\Data.sav
	Active Dataset	DataSet1
	Filter	<none>
	Weight	<none>
	Split File	<none>
	N of Rows in Working Data File	105
Missing Value Handling	Definition of Missing	User-defined missing values are treated as missing.
	Cases Used	Statistics are based on cases with no missing values for any variable used.
Syntax		REGRESSION /MISSING LISTWISE /STATISTICS COEFF OUTS R ANOVA /CRITERIA=PIN(.05) POUT(.10) /NOORIGIN /DEPENDENT q10_c2 /METHOD=ENTER q9_1 q9_2 q9_3 q9_4 q9_5 q9_6 q9_7.
Resources	Processor Time	0:00:00.078
	Elapsed Time	0:00:00.205
	Memory Required	5620 bytes
	Additional Memory Required for Residual Plots	0 bytes

[DataSet1] C:\Users\sersy\Desktop\Imparical Part\Data.sav

#### Variables Entered/Removed

Model	Variables Entered	Variables Removed	Method
1	q9_7, q9_4, q9_5, q9_2, q9_3, q9_6, q9_1 <sup>a</sup>		Enter

a. All requested variables entered.

#### Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.353 <sup>a</sup>	.125	.050	1.706

a. Predictors: (Constant), q9\_7, q9\_4, q9\_5, q9\_2, q9\_3, q9\_6, q9\_1

#### ANOVA<sup>b</sup>

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	33.970	7	4.853	1.668	.128 <sup>a</sup>
	Residual	238.519	82	2.909		
	Total	272.489	89			

a. Predictors: (Constant), q9\_7, q9\_4, q9\_5, q9\_2, q9\_3, q9\_6, q9\_1

b. Dependent Variable: q10\_c2

#### Coefficients<sup>a</sup>

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	.980	.904		1.085	.281
	q9_1	.419	.265	.187	1.580	.118
	q9_2	.024	.232	.012	.102	.919
	q9_3	.140	.239	.068	.587	.559
	q9_4	.099	.221	.051	.446	.657
	q9_5	.281	.231	.132	1.218	.227
	q9_6	.279	.218	.146	1.277	.205
	q9_7	-.438	.195	-.240	-2.241	.028

a. Dependent Variable: q10\_c2



## General Appendices

```
REGRESSION /MISSING LISTWISE /STATISTICS COEFF OUTS R ANOVA
/CRITERIA=PIN(.05) POUT(.10) /NOORIGIN /DEPENDENT q10_b1
/METHOD=ENTER q9_1 q9_2 q9_3 q9_4 q9_5 q9_6 q9_7.
```

### Regression

		Notes
Output Created		21-2010-04- AST 15:22:52
Comments		
Input	Data	C:\Users\sersy\Desktop\Imparical Part\Data.sav
	Active Dataset	DataSet1
	Filter	<none>
	Weight	<none>
	Split File	<none>
	N of Rows in Working Data File	105
Missing Value Handling	Definition of Missing	User-defined missing values are treated as missing.
	Cases Used	Statistics are based on cases with no missing values for any variable used.
Syntax		REGRESSION /MISSING LISTWISE /STATISTICS COEFF OUTS R ANOVA /CRITERIA=PIN(.05) POUT(.10) /NOORIGIN /DEPENDENT q10_b1 /METHOD=ENTER q9_1 q9_2 q9_3 q9_4 q9_5 q9_6 q9_7.
Resources	Processor Time	0:00:00.078
	Elapsed Time	0:00:00.208
	Memory Required	5620 bytes
	Additional Memory Required for Residual Plots	0 bytes

[DataSet1] C:\Users\sersy\Desktop\Imparical Part\Data.sav

### Variables Entered/Removed

Model	Variables Entered	Variables Removed	Method
1	q9_7, q9_3, q9_4, q9_5, q9_2, q9_6, q9_1 <sup>a</sup>		Enter

a. All requested variables entered.

### Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.387 <sup>a</sup>	.150	.079	1.612

a. Predictors: (Constant), q9\_7, q9\_3, q9\_4, q9\_5, q9\_2, q9\_6, q9\_1

### ANOVA<sup>b</sup>

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	38.488	7	5.498	2.117	.050 <sup>a</sup>
	Residual	218.164	84	2.597		
	Total	256.652	91			

a. Predictors: (Constant), q9\_7, q9\_3, q9\_4, q9\_5, q9\_2, q9\_6, q9\_1

b. Dependent Variable: q10\_b1

### Coefficients<sup>a</sup>

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	1.926	.850		2.265	.028
	q9_1	.140	.249	.065	.563	.575
	q9_2	-.057	.214	-.029	-.265	.792
	q9_3	.482	.219	.250	2.250	.027
	q9_4	-.244	.205	-.132	-1.192	.237
	q9_5	.306	.216	.151	1.418	.160
	q9_6	.174	.202	.096	.861	.391
	q9_7	-.306	.182	-.175	-1.681	.096

a. Dependent Variable: q10\_b1

## General Appendices

```
REGRESSION /MISSING LISTWISE /STATISTICS COEFF OUTS R ANOVA
/CRITERIA=PIN(.05) POUT(.10) /NOORIGIN /DEPENDENT q10_b1
/METHOD=ENTER q9_1 q9_2 q9_3 q9_4 q9_5 q9_6 q9_7.
```

### Regression

Notes	
Output Created	21-2010-04- AST 15:22:52
Comments	
Input	Data C:\Users\sersy\Desktop\Imparical Part\Data.sav
	Active Dataset DataSet1
	Filter <none>
	Weight <none>
	Split File <none>
	N of Rows in Working Data File 105
Missing Value Handling	Definition of Missing User-defined missing values are treated as missing.
	Cases Used Statistics are based on cases with no missing values for any variable used.
Syntax	REGRESSION /MISSING LISTWISE /STATISTICS COEFF OUTS R ANOVA /CRITERIA=PIN(.05) POUT(.10) /NOORIGIN /DEPENDENT q10_b1 /METHOD=ENTER q9_1 q9_2 q9_3 q9_4 q9_5 q9_6 q9_7.
Resources	Processor Time 0:00:00.078
	Elapsed Time 0:00:00.208
	Memory Required 5620 bytes
	Additional Memory Required for Residual Plots 0 bytes

[DataSet1] C:\Users\sersy\Desktop\Imparical Part\Data.sav

#### Variables Entered/Removed

Model	Variables Entered	Variables Removed	Method
1	q9_7, q9_3, q9_4, q9_5, q9_2, q9_6, q9_1 <sup>a</sup>		Enter

a. All requested variables entered.

#### Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.367 <sup>a</sup>	.150	.079	1.612

a. Predictors: (Constant), q9\_7, q9\_3, q9\_4, q9\_5, q9\_2, q9\_6, q9\_1

#### ANOVA<sup>b</sup>

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	38.488	7	5.498	2.117	.050 <sup>a</sup>
	Residual	218.164	84	2.597		
	Total	256.652	91			

a. Predictors: (Constant), q9\_7, q9\_3, q9\_4, q9\_5, q9\_2, q9\_6, q9\_1

b. Dependent Variable: q10\_b1

#### Coefficients<sup>a</sup>

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	1.926	.850		2.265	.026
	q9_1	.140	.249	.065	.563	.575
	q9_2	-.057	.214	-.029	-.265	.792
	q9_3	.492	.219	.250	2.250	.027
	q9_4	-.244	.205	-.132	-1.192	.237
	q9_5	.306	.216	.151	1.418	.160
	q9_6	.174	.202	.096	.861	.391
	q9_7	-.306	.182	-.175	-1.681	.096

a. Dependent Variable: q10\_b1

## General Appendices

```
REGRESSION /MISSING LISTWISE /STATISTICS COEFF OUTS R ANOVA
/CRITERIA=PIN(.05) POUT(.10) /NOORIGIN /DEPENDENT q10_b2
/METHOD=ENTER q9_1 q9_2 q9_3 q9_4 q9_5 q9_6 q9_7.
```

### Regression

Notes		21-2010-مئي AST 15:23:53
Output Created		
Comments		
Input	Data	C:\Users\sersy\Desktop\Imparical Part\Data.sav
	Active Dataset	DataSet1
	Filter	<none>
	Weight	<none>
	Split File	<none>
	N of Rows in Working Data File	105
Missing Value Handling	Definition of Missing	User-defined missing values are treated as missing.
	Cases Used	Statistics are based on cases with no missing values for any variable used.
Syntax		REGRESSION /MISSING LISTWISE /STATISTICS COEFF OUTS R ANOVA /CRITERIA=PIN(.05) POUT(.10) /NOORIGIN /DEPENDENT q10_b2 /METHOD=ENTER q9_1 q9_2 q9_3 q9_4 q9_5 q9_6 q9_7.
Resources	Processor Time	0:00:00.046
	Elapsed Time	0:00:00.067
	Memory Required	5620 bytes
	Additional Memory Required for Residual Plots	0 bytes

[DataSet1] C:\Users\sersy\Desktop\Imparical Part\Data.sav

#### Variables Entered/Removed

Model	Variables Entered	Variables Removed	Method
1	q9_7, q9_1, q9_2, q9_5, q9_4, q9_6, q9_3 <sup>a</sup>		Enter

a. All requested variables entered.

#### Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.539 <sup>a</sup>	.290	.228	1.685

a. Predictors: (Constant), q9\_7, q9\_1, q9\_2, q9\_5, q9\_4, q9\_6, q9\_3

#### ANOVA<sup>b</sup>

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	92.892	7	13.270	4.673	.000 <sup>a</sup>
	Residual	227.188	80	2.840		
	Total	320.080	87			

a. Predictors: (Constant), q9\_7, q9\_1, q9\_2, q9\_5, q9\_4, q9\_6, q9\_3

b. Dependent Variable: q10\_b2

#### Coefficients<sup>a</sup>

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	1.173	.894		1.312	.193
	q9_1	.447	.270	.182	1.658	.101

## General Appendices

q9_2	.097	.232	.043	.420	.676
q9_3	.653	.237	.290	2.757	.007
q9_4	-.203	.220	-.095	-.924	.358
q9_5	.553	.231	.235	2.396	.019
q9_6	-.163	.216	-.079	-.754	.453
q9_7	-.541	.183	-.273	-2.807	.006

a. Dependent Variable: q10\_b2

```
REGRESSION /MISSING LISTWISE /STATISTICS COEFF OUTS R ANOVA
/CRITERIA=PIN(.05) POUT(.10) /NOORIGIN /DEPENDENT q10_b3
/METHOD=ENTER q9_1 q9_2 q9_3 q9_4 q9_5 q9_6 q9_7.
```

### Regression

Notes		21-2010-مئي AST 15:24:31	
Output Created			
Comments			
Input	Data	C:\Users\sersy\Desktop\Imparical	
	Active Dataset	DataSet1	
	Filter	<none>	
	Weight	<none>	
	Split File	<none>	
	N of Rows in Working Data	105	
Missing Value Handling	Definition of Missing	User-defined missing values are treated	
	Cases Used	Statistics are based on cases with no	
Syntax		REGRESSION	
Resources	Processor Time	0:00:00.031	
	Elapsed Time	0:00:00.202	
	Memory Required	5620 bytes	
	Additional Memory Required	0 bytes	

[DataSet1] C:\Users\sersy\Desktop\Imparical Part\Data.sav

#### Variables Entered/Removed

Model	Variables Entered	Variables Removed	Method
1	q9_7, q9_1, q9_2, q9_5,		. Enter

a. All requested variables entered.

#### Model Summary

Model	R	R Square	Square	Estimate
1	.469 <sup>a</sup>	.220	.151	1.640

a. Predictors: (Constant), q9\_7, q9\_1, q9\_2, q9\_5, q9\_4, q9\_3, q9\_6

#### ANOVA<sup>b</sup>

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	59.821	7	8.546	3.178	.005 <sup>a</sup>
	Residual	212.409	79	2.689		
	Total	272.230	86			

a. Predictors: (Constant), q9\_7, q9\_1, q9\_2, q9\_5, q9\_4, q9\_3, q9\_6

b. Dependent Variable: q10\_b3

#### Coefficients<sup>a</sup>

Model		Unstandardized Coefficients		Coefficients		t	Sig.
		B	Std. Error	Beta			
1	(Constant)	2.202	.873			2.524	.014
	q9_1	.556	.263	.243		2.113	.038
	q9_2	-.114	.227	-.054		-.504	.616
	q9_3	.475	.234	.225		2.030	.046
	q9_4	-.021	.216	-.010		-.095	.924
	q9_5	.349	.226	.160		1.542	.127
	q9_6	-.081	.214	-.042		-.378	.706
	q9_7	-.361	.189	-.196		-1.908	.060

a. Dependent Variable: q10\_b3

GET

## General Appendices

```

FILE='C:\Users\KHALID-OMAR\Downloads\Data (3).sav'.
DATASET NAME DataSet1 WINDOW=FRONT.
FACTOR
/VARIABLES q9_1 q9_2 q9_3 q9_4 q9_5 q9_6 q9_7 q10_a1 q10_a2 q10_b1 q10_b2
q10_b3 q10_c1 q10_c2 /MISSING LISTWISE /ANALYSIS q9_1 q9_2 q9_3 q9_4 q9_5
q9_6 q9_7 q10_a1 q10_a2 q10_b1 q10_b2 q10_b3 q10_c1 q10_c2
/PRINT INITIAL CORRELATION KMO EXTRACTION ROTATION
/FORMAT SORT BLANK(.30)
/PLOT EIGEN
/CRITERIA MINEIGEN(1) ITERATE(25)
/EXTRACTION PC
/CRITERIA ITERATE(25) DELTA(0)
/ROTATION OBLIMIN
/METHOD=CORRELATION .

```

## Factor Analysis

### Notes

Output Created		11-JUN-2014 20:38:19
Comments		
Input	Data	C:\Users\KHALID-OMAR\Down-loads\Data (3).sav
	Active Dataset	DataSet1
	Filter	<none>
	Weight	<none>
	Split File	<none>
	N of Rows in Working Data File	105
Missing Value Handling	Definition of Missing	MISSING=EXCLUDE: User-defined missing values are treated as missing.
	Cases Used	LISTWISE: Statistics are based on cases with no missing values for any variable used.
Syntax		FACTOR /VARIABLES q9_1 q9_2 q9_3 q9_4 q9_5 q9_6 q9_7 q10_a1 q10_a2 q10_b1 q10_b2 q10_b3 q10_c1 q10_c2 /MISSING LISTWISE /ANALYSIS q9_1 q9_2 q9_3 q9_4 q9_5 q9_6 q9_7 q10_a1 q10_a2 q10_b1 q10_b2 q10_b3 q10_c1 q10_c2 /PRINT INITIAL CORRELATION KMO EXTRACTION ROTATION /FORMAT SORT BLANK(.30) /PLOT EIGEN /CRITERIA MINEIGEN(1) ITERATE(25) /EXTRACTION PC /CRITERIA ITERATE(25) DELTA(0)

## General Appendices

Resources	Elapsed Time	/ROTATION OBLIMIN /METHOD=CORRELATION .
		0:00:00.18
	Maximum Memory Required	24872 (24.289K) bytes
	Processor Time	0:00:00.20

[DataSet1] C:\Users\KHALID-OMAR\Downloads\Data (3).sav

**Correlation Matrix**

		q9_1	q9_2	q9_3	q9_4	q9_5	q9_6	q9_7	q10_a1
Correlation	q9_1	1.000	.088	.281	-.247	.159	-.173	.056	-.150
	q9_2	.088	1.000	-.174	.110	-.079	.183	.104	.163
	q9_3	.281	-.174	1.000	.152	.090	.094	.073	-.069
	q9_4	-.247	.110	.152	1.000	.060	.312	.067	.206
	q9_5	.159	-.079	.090	.060	1.000	.136	.112	.056
	q9_6	-.173	.183	.094	.312	.136	1.000	.211	.270
	q9_7	.056	.104	.073	.067	.112	.211	1.000	.002
	q10_a1	-.150	.163	-.069	.206	.056	.270	.002	1.000
	q10_a2	.018	.025	.160	.137	-.167	.119	-.047	.235
	q10_b1	.155	-.081	.312	-.060	.172	.062	-.162	.401
	q10_b2	.339	-.048	.333	-.138	.232	-.109	-.238	.113

## General Appendices

q10_b3	.327	-.114	.292	-.048	.188	-.104	-.171	.225
q10_c1	.106	.053	.270	.131	.109	.117	-.021	.275
q10_c2	.152	.011	.146	.087	.171	.094	-.193	.371

### KMO and Bartlett's Test

Kaiser-Meyer-Olkin Measure of Sampling Adequacy.	.655
Bartlett's Test of Sphericity	Approx. Chi-Square
	347.440
	df
	91
	Sig.
	.000

### Communalities

	Initial	Extraction
q9_1	1.000	.753
q9_2	1.000	.767
q9_3	1.000	.765
q9_4	1.000	.546
q9_5	1.000	.729
q9_6	1.000	.579
q9_7	1.000	.574
q10_a1	1.000	.645
q10_a2	1.000	.667
q10_b1	1.000	.667
q10_b2	1.000	.677
q10_b3	1.000	.770
q10_c1	1.000	.484
q10_c2	1.000	.660

Extraction Method: Principal Component Analysis.

### Total Variance Explained

Component	Initial Eigenvalues			Extraction Sums of Squared Loadings			Rotation Sums of Squared Loadings(a)
	Total	% of Variance	Cumulative %	Total	% of Variance	Cumulative %	Total
1	3.588	25.628	25.628	3.588	25.628	25.628	3.522
2	2.004	14.312	39.940	2.004	14.312	39.940	1.901
3	1.387	9.908	49.848	1.387	9.908	49.848	1.524
4	1.179	8.421	58.269	1.179	8.421	58.269	1.306
5	1.124	8.029	66.297	1.124	8.029	66.297	1.309

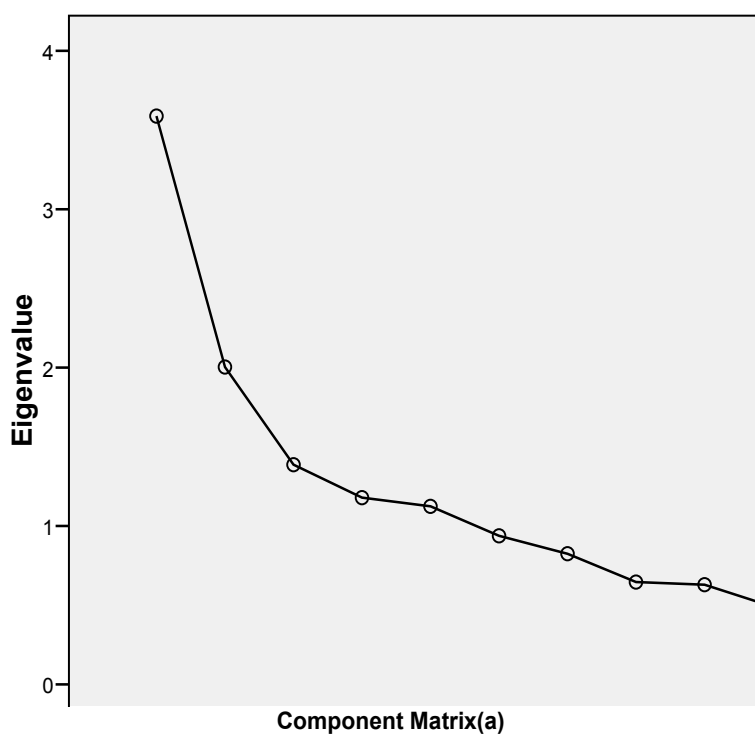
## General Appendices

6	.938	6.701	72.998			
7	.825	5.893	78.891			
8	.646	4.616	83.507			
9	.629	4.495	88.002			
10	.490	3.501	91.503			
11	.454	3.241	94.744			
12	.322	2.298	97.042			
13	.226	1.617	98.659			
14	.188	1.341	100.000			

Extraction Method: Principal Component Analysis.

a. When components are correlated, sums of squared loadings cannot be added to obtain a total variance.

### Scree Plot



	Component				
	1	2	3	4	5
q10_b3	.854				
q10_b1	.803				
q10_c2	.746				
q10_b2	.744	-.343			
q10_c1	.600	.308			
q9_6		.687	.305		
q9_4		.644			
q10_a1	.410	.576			
q9_7			.653		



## General Appendices

q9_5			.543	.452	-.391
q9_3	.454		.463	-.577	
q10_a2	.342	.315		-.558	
q9_2		.355		.364	.709
q9_1	.354	-.458	.421		.491

Extraction Method: Principal Component Analysis.  
a 5 components extracted.

### Pattern Matrix(a)

	Component				
	1	2	3	4	5
q10_b3	.844				
q10_b1	.805				
q10_c2	.804				
q10_b2	.731				
q10_c1	.536				
q10_a1	.510	.396	-.372		
q9_4		.740			
q9_6		.706			
q9_3			.720		-.361
q9_1		-.503	.604		
q9_7	-.334	.301	.508		
q9_5	.311			.776	
q10_a2				-.721	
q9_2					.879

Extraction Method: Principal Component Analysis.  
Rotation Method: Oblimin with Kaiser Normalization.  
a Rotation converged in 19 iterations.

### Structure Matrix

	Component				
	1	2	3	4	5
q10_b3	.849				
q10_b1	.809				
q10_c2	.784				
q10_b2	.730				
q10_c1	.581				
q10_a1	.481	.468	-.312		.325
q9_6		.725			
q9_4		.725			
q9_3	.325		.731		-.336
q9_1		-.453	.642		
q9_7		.313	.481		.343
q9_5				.741	
q10_a2				-.738	
q9_2					.870

Extraction Method: Principal Component Analysis.

## General Appendices

---

Rotation Method: Oblimin with Kaiser Normalization.

**Component Correlation Matrix**

Component	1	2	3	4	5
1	1.000	.049	.122	-.087	-.023
2	.049	1.000	-.005	-.065	.152
3	.122	-.005	1.000	.070	.008
4	-.087	-.065	.070	1.000	.033
5	-.023	.152	.008	.033	1.000

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

Monte Carlo PCA for Parallel Analysis  
Version 2.5

6/11/2014 1:12

Number of variables: 14  
Number of subjects: 105  
Number of replications: 25

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Eigenvalue #	Random Eigenvalue	Standard Dev	
1	1.6969	.0975	3.646
2	1.5025	.0668	2.151
3	1.3650	.0473	1.474
4	1.2516	.0572	1.233
5	1.1768	.0369	1.091
6	1.0791	.0349	1.015
7	0.9941	.0447	
8	0.9214	.0414	
9	0.8553	.0421	
10	0.7827	.0358	
11	0.7178	.0379	
12	0.6367	.0403	
13	0.5512	.0456	
14	0.4690	.0505	

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6/11/2014 1:12

Monte Carlo PCA for Parallel Analysis

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