

## Quality of accounting audit in Albania, perceptions of accounting experts and members of audit committees

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### Abstract

The purpose of this paper is to provide insight into the way in which the concept of audit quality is perceived. In particular, the paper focuses on the viewpoints of the parties involved in the audit market, such as the auditors and members of the Audit Committee of the audited companies, which have available the relevant information and technical knowledge to properly assess the quality of the audit. The paper examines the way in which the quality of the audit is perceived and the way, in which it is displayed, which actions, symbols and behaviors auditors/audit firms present to third parties that have a proper audit quality. The study shows that respondent's groups perceive a good level of audit quality, though not the maximum, and that the perception of the quality of the audit is consistent between the two surveyed parties. Also, research indicates that audit firms and auditors use different symbols and behaviors to communicate to the market that apply proper audit quality. In general, the findings of the paper can be considered important for the stakeholders, for audit engagements and for academic researchers wishing to develop a deeper understanding of this contribution.

**Keywords:** *perceived audit quality, social context, audit committee, EDF, behavior and symbols.*  
*JEL code: M42*

### Introduction

There are different actors involved in the audit process, auditors, audit committee members, audited company management, investors and regulators. Each of these groups may affect the auditor's decisions, and each may have different opinions on what constitutes a qualitative audit. My contribution to the relevant literature in Albania is the analysis of the perceptions of some of the parties involved in the audit process, the level of quality of the current audit, and the manner in which this audit is performed by auditors / audit companies. All this taking into account the social, legal and cultural context in which the profession of auditor is exercised. To understand the audit, it is useful to first understand the reasoning behind the exercise of this profession and the role of external auditors. Company audits exist due to the division between ownership and control of societies in the modern economy where shareholders or partners have given resources to managers in order to maximize their wealth. Since there is the presence of opportunistic managers who may not report the true state of the company's performance, which can cause loss to the owners, the role of auditors has as a consequence impact on reducing agency costs due to information asymmetry and interests between the two above mentioned parties. For this reason, the agency's theory, which concerns the control and asymmetry of information between shareholders and managers, is normally used to legitimize the importance

of auditing in the modern economy (Jensen MC and Meckling WH, 1976; Arnold B. and de Lange P., 2004). The verification process involves the collection and evaluation of evidence, which are the basis for the auditor to form his or her professional opinion or judgment on the financial statements. It is argued that the value of audit services depends on the form of opinion issued by auditors, and therefore, the value of the audit opinion depends on the quality of audit work performed by the auditor (Moizer P., 2005). The quality of the audit is therefore important because it affects the reliability of the audit opinion. If auditors perform a weak audit, the opinion given in relation to the audited financial statements may be fraudulent and this would definitely affect the economic decisions of their users. Audit quality is thought to protect the economic interest of owners and other stakeholders by increasing the value of the financial statements prepared by the managers. Concerns about the quality of the audit and the factors that influence it have been the object of longstanding interest in academic debates about accounting auditing. The importance of social and institutional audit dimensions is increasingly recognized and involved in various international studies (Humphrey C. and Moizer P., 1990; Carpenter B. and Smith M., 1993; Curtis E. and Turley S., 2007; Hudaib M. and Haniffa R., 2009). Despite the development of studies that place greater emphasis on the significance of the audit activity, so far little attention has been paid to exploring the way the concept of quality of audit is built into practice in the context of the institutional and social environment, in particular referring to Albania. Specifically, there is little evidence of how auditing practitioners perceive the current level of quality and how they translate the overall concept of auditing quality into conduct, so carrying out audits in practice.

### **1.1 Purpose of the study**

This paper aims at studying the way in which the quality of audit in Albania is perceived and how it is presented in concrete terms. All this will be assessed by considering the views of the specialized auditing market participants, so that, the evidence collected and the results achieved are the result of the opinion of figures with technical and professional competence in the sector, and considering the social, legal and cultural context in which the profession of auditor is exercised. This study is a significant contribution to this topic, as there has been no detailed research in Albania, that at the same time has explored these different aspects while considering the context and viewpoints of the various stakeholders involved in the audit process. The objectives of the paper can be summarized as follows:

- understanding of the way in which audit quality is perceived by key stakeholders in the audit process in Albania;
- the meaning of the way in which the quality of the audit is displayed, through which instruments;
- or behavior is communicated;

### **1.2 Research questions, hypotheses and methodology**

The drafting of the paper is done in the function of 2 (two) research questions in order

to resolve the questions.

**First Research Question:** How is the concept of audit quality perceived by key stakeholders in the audit process? This question was answered by two respondents, active auditors and audit committee members. Responses are referred to audit work, auditor characteristics and audit process.

**Second Research Question:** How does audit quality appear in practice? This question is intended to identify the way in which the quality of the audit is communicated in practice, so through which behavior, symbols, auditors or audit firms communicate to third parties that they have a proper level of audit quality.

The selected methodology for conducting the study is based on survey techniques, applied to two different categories of respondents.

The first group, the active auditors, the total population, 208 professionals, according to the IEKA official register and the second group of audit committee members, the total population, 70 professionals, enrolled at the Institute of Internal Audits, according to the data communicated by the executive director of this institute, as the list of names has not been officially published for privacy reasons.

The data collected through the survey system will be processed in order to provide answers to research questions.

Likewise, the evidence collected between the two groups of respondents will be compared for the common questions that make this comparison possible.

### 1.3 Contribution of the work

From the research conducted, the work in this field in Albania is limited, above all the research that considers the views of the various parties involved, and at the same time consider the contextual aspects of the audit work.

### 1.4 Literature on Quality Audit Perceptions

Studies on the way in which audit quality is perceived can generally be divided into two groups: studies on users' perceptions and financial statements preparers, and expectations survey on auditor figure. These are briefly discussed below.

#### **Perceptions of the users and the preparation for the quality of the audit**

Previous research has investigated the perceptions of users and financial statements preparers on audit quality and has come to the conclusion that the preparers, users and auditors see the quality of audit differently (Schroeder MS et al., 1986; Knapp MC, 1991; Carcello JV et al., 1997; Chen CJP et al., 2001; Duff A., 2004).

Schroeder M.S. (1986) examined the perception of the chairmen of the audit committee and of the partners on engaging the factors that could affect the quality of external audits. The findings showed that audit committee chairpersons perceive the factors of the audit team (such as the number of partners and managers in the audit, the planning and performance of the audit team's work and communication between the audit team and management) to be more important than audit firm's factors (such as fees, size and reputation) in assessing the quality of the audit. The findings highlighted a significant difference between the engagement partners and the chairmen of the audit committee on six factors: independence, team rotation, quality control procedures, technical skills of auditors,

reputation and communication between the audit team and the audit committee. Knapp M.C., 1991, investigated the impact of the size of the audit, the audit mastery, and the overall audit strategy, considering the perceptions of the members of the audit committee on the quality of the audit. Using an experimental study of 122 audit committee members in the US, he found that members perceive that auditor size and auditor ownership significantly affect audit quality. Carcello J.V. et al (1992) examined the perceptions of financial controllers, institutional investors and engagement partners on audit quality through a questionnaire survey. The results showed that the three groups perceive the audit team's factors as more important than the audit firms factors in increasing the quality of the audit. Significant differences were reported between preparers / users and audit partners in relation to quality factors such as compliance with audit standards, the nature and extent of non-audit services, quality control standards, and professional certification for auditing company staff. In general, team factors and individual factors such as competence, ethics, and communication between the audit team and the management of the client company received high estimation as factors that could improve the quality of the audit. Otherwise, factors such as providing consultancy services, cost orientation of audit firms, and audit rotation are perceived as less important in determining the quality of the audit.

Duff A. (2004) argued that besides the standard definition of audit quality (independence and competence) aspects such as customer service, sensitivity, quality of service and accountability

should be considered as a broader view of audit quality. Beattie V. et al, 2011 reviewed the perceptions of two hundred and nineteen auditing partners, one hundred and thirty members of the audit committee, and one hundred and forty-nine chief financial officers regarding the impact of regulatory and economic factors on UK audit quality. Five were the factors that were perceived as most influential to the audit quality by respondents: 1) communication between external auditors and AC; 2) CA financial background; 3) the independence of the auditor; 4) the size of the audit firm; and 5) the composition of the board by independent non-executive directors. In contrast, 3 were the factors that were considered by respondents as a threatening quality factor audit: 1) time and cost for changing auditors; 2) budgeted pressures on staff; and 3) not a large auditing firm. It can be summed up that some aspects are apparent in this review of previous research. First, there is no consensus on what the quality of the audit means. Preparers, users and auditors see the quality of audit differently. Second, what constitutes audit quality is subjective and varies depending on the perception and expectation of different parties regarding audit services.

### **Studies on expectations from the audit activity**

Another area of audit literature related to the issue of audit quality is that of studying audit expectations. The expectation set for the role of the external auditor is to improve the reliability of financial information through independent verification of financial statements, as chronologically confirmed by Mautz R.K. and Sharaf H.A, 1961, Wilcox K.A. and Smith C.H., 1977, and by Wallace W.A,

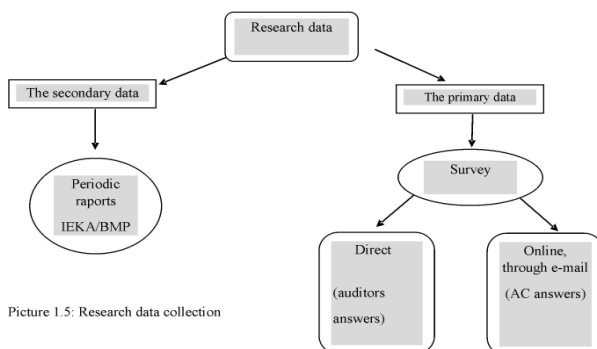
1980. Referring to the professional standard, ISA 200, auditors are expected to express a true and fair view on the financial statements, which is consistent with the financial reporting framework in force. The company's management expects external auditors to provide value-added services and non-audit services (Mills SK and Bettner MS, 1992; Beattie V. and Fearnley S., 1995). The public expects external auditors to guard companies against fraud and error (Percy JP, 2007). Some past research has shown that different expectations on the role of auditors have resulted in different perceptions and expectations regarding the quality of audit services this according to Carcello J.V. et al, 1992 and following according to Sutton S.G., 1993. Researches on audit quality perceptions are generally part of one of the following categories: 1) research through a survey instrument that aims to understand general perceptions and 2) research on behavior that focuses on specific aspects and circumstances.

#### *Search through the survey*

Schroeder M.S. et al., 1986, surveyed engagement partners and company audit committees according to Fortune 500 and asked them to evaluate 15 factors based on their perception of their impact on audit quality. These factors were composed by team engagement factors (eg partner level of attention to auditing, planning and performance of audit work, communication between audit team and management) and comprehensive audit firm's factors (p. eg the keeping of technically updated auditors, the quality control procedures of the audit firm, the legal expertise of the audit firm). The responses indicated that the two respondents in general assessed the engagement team's factors as the most important indicators of audit quality. While three factors had a slight impact assessment: the judicial processes in which the audit firm was involved, peer review findings, and professional fees.

Carcello J.V., 1992, expanded the work of Schroeder M.S et al, 1986, adding to other audit quality factors in their survey and including company engagement partners, Fortune 1000, and sophisticated investors. Similarly to Schroeder M.S et al, 1986, they found that the characteristics associated with the engagement team are perceived as more important to the quality of the audit than the features associated with audit societies. Overall, four were the most important factors: team engagement and customer experience, customer response, industry expertise, and compliance with general standards (competence, independence and proper care). Although these studies are important to understanding the quality of the audit, both surveys have been conducted before the Sarbanes-Oxley Act (SOX) comes into force. Due to the major changes in SOX implemented in the audit process, attitudes and perceptions on audit quality may have changed since these studies have been conducted. Christensen B.E. et al, 2014, have a working paper that examines perceptions on audit quality from the point of view of engagement partners and specialized investors. They noted that auditors focus on compliance with regulations and professional standards when assessing audit quality; while investors focus more on the individual characteristics of auditors in the engagement team. These responses indicate that auditors are increasing their focus on technical aspects of auditing, during the period after SOX. Investors who have limited knowledge in the audit process are still focused on individual characteristics. Despite the differences between the groups in

what constitutes the quality of the audit, the two groups agree that the reviews are the best indicator of low audit quality.



Picture 1.5: Research data collection

### 1.5 Source, data collection and sampling

In this paper, the study of official publications and reports, and questionnaires will be used to answer the research question.

#### Collection of data from the questionnaire

The first group of respondents is the one of active auditors registered at IEKA. Currently the number of active auditors is 208.

For the purposes of the survey a casual sampling method was used, through direct distribution of the questionnaires, during the annual auditors training held at the Tirana International Hotel, on dt. 23/11/2018. The second respondent group is that of the members of the Audit Committees. Initially, it was planned to include members of the audit committees of all banks operating in Albania and of the 50 most profitable companies for 2017, referring to data published by information institutions relevant officer.

The sampled sample was sent to the questionnaire, and it was contacted several times for its completion, both via email and phone.

No response was received from this way of selecting and contacting the sample. As a result, the sample was changed and sampled 25 members of the Institute of Internal Auditors of Albania, whose total number is currently 70, according to the verbal confirmation of the Executive Director of the Institute, as the detailed list is not published for privacy reasons. Only the responses received from the internal audit committee member were considered.

Table 1.5: The sample chosen for survey and the number of te taken answers

|     |     |                               |
|-----|-----|-------------------------------|
| EDF | 208 | Active auditors               |
|     | 70  | The sample selected by chance |
|     | 33% | The selected sample           |
|     | 29  | Questionnaire answers         |
|     | 41% | Answers                       |

|   |     |   |
|---|-----|---|
| Internal auditors registered at the IIA | 70  | Internal auditors, members or not at the Audit Committee (AC)   |
|   | 25  | The sample selected by chance                                   |
|   | 36% | The selected sample   |
|   | 8   | Questionnaire answers(answers from the Audit Committee members) |
|   | 32% | Questionnaire answers(Audit Committee members)                  |

## 1.6 Design of the questionnaire

### *The auditors questionnaire*

The form of questions used in the questionnaire includes a Likert scale from one to five points for the answer. A Likert scale has the advantages of being relatively easy to build and administer and easily understood by respondents, making it particularly useful. The questionnaire consists of closed questions. Care was also taken at the length of the questionnaire, ensuring that it covers all important issues. In formulating the questions asked, care has also been taken to ensure that they are clear and understandable. Confidentiality of the information provided to the respondents is guaranteed in providing the questionnaire. The questionnaire used in the study was developed after reviewing the previous literature.

### The questionnaire is structured in 3 sections

Section 1, aims to identify the general characteristics of the sample.

Section 2, aims to identify the way in which the concept of audit quality by key stakeholders in the audit process is perceived, more specifically, audit work, auditor characteristics and contextual aspects of audit work.

Section 3, is intended to highlight the way in which the concept of audit quality appears practically as a result of the instruments used by auditors or audit firms to communicate to third parties that they apply a high quality of audit.

### **Audit Member Questionnaire**

### The questionnaire is structured in 2 sections

Section 1, aims to identify the general characteristics of the sample.

Section 2, aims to identify the way in which the concept of audit quality is perceived in practice by members of the audit committees of client companies.

*Table 1.6: The connection scheme of: research questions-hypothesis-questionnaire*

| Research questions  | Sections of the questionnaire<br>Auditors/Audit Partner | Sections of the<br>questionnaire/AC<br>Member |
|---------------------|---|---|
| Research question 1 | Sectioni 2  | Section 2                                     |
| Research question 2 | Section 3   | n/a   |

*Source: Autor*

The two groups of respondents can be considered as reliable sources regarding the subject under investigation. These groups are in one way or another involved

in assessing and achieving audit quality in practice. For auditors, they are responsible for carrying out the audits they consider to be of adequate quality. Therefore, it is important whether they are fulfilling their responsibility to do a good job or to provide the quality of audit expected by the users of audit services. For AC members, they are part of the important governance mechanism that is responsible for commissioning, monitoring and reviewing the effectiveness of the external audit function, which protects the shareholders' interests through improving the quality of the audit and the quality of financial reporting. Thus, issues pertaining to the fulfillment of these foreseen roles are important.

## 2. Results and Interpretations

### Perceived quality of audit.

*First research question:* How is the quality of audit audited by key stakeholders in the audit process perceived in practice? This question was answered by two respondents, active auditors and audit committee members. Responses are referred to audit work, auditor characteristics and audit process.

#### *Auditors responses*

Section 2 of the questionnaire has been comprised of 3 sub-sections, on audit work, auditor characteristics and the context of the audit work.

The responses from the auditors indicate that the quality of the Likert scale used is estimated at the average value of 4, not the maximum, but the auditors perceive the presence of a good level of audit quality.

The aspects that are perceived to be of the highest quality value are those related to the characteristics of the auditor, followed by the audit work and the context of the audit work.

The aspects related to the characteristics of the auditor, perceived with the highest level of quality, are professional exercise with professional skepticism and good knowledge of the audit client, followed by professional competence and experience in the audit work.

Aspects related to the audit work, perceived with the highest level of quality, are the proper maintenance of job documentation, compliance with legal requirements and methodology adapted to developments in professional standards.

Regarding aspects related to the context of the audit work, it is considered that the information systems and financial reporting periodicity are appropriate and positively affect the quality of the audit.

#### *2.1 Section 2 answers, auditors Questionnaire*

| Section 2/Auditors Questionnaire   | Average rating |
|--|----------------|
| Statements on audit engagement   | 4.02           |
| 1. The audit is carried out in accordance with the requirements of the law, regulations and professional and ethical standards | 4.2            |



|   |             |
|---|-------------|
| 2. The auditor uses the information technology appropriately.   | 3.8         |
| 3. There is interaction between auditors and others involved in the audit, including internal auditors.                                 | 3.5         |
| 4. There are appropriate arrangements with the client management commitment in order to achieve audit effectiveness.                    | 4.1         |
| 5. There is proper audit documentation.   | 4.2         |
| 6. Audit methodology is tailored to developments in professional standards.   | 4.2         |
| <b>Statements on characteristics of the auditor</b>   | <b>4.11</b> |
| 1. The auditor behaves objectively and integratively  | 4.1         |
| 2. The auditor is independent   | 4.2         |
| 3. The auditor represents professional competence and due diligence   | 4.2         |
| 4. The auditor acts with professional skepticism  | 4.2         |
| 5. The auditor understands the business activity exercised by the client  | 4.3         |
| 6. The person who heads the audit office has sufficient experience, their work is directed, overseen and reviewed, and staff continuity | 4.2         |
| 7. The auditor has sufficient time to undertake the audit effectively.  | 4           |
| 8. The auditor is accessible to management and other charge-makers with governance.   | 3.8         |
| 9. The largest audit firms offer a better audit service because they have sufficient resources available                                | 3.6         |
| <b>Statements on the contextual aspects of the audit work</b>   | <b>3.73</b> |
| 1. Business practices and commercial law favor the quality of the audit work  | 3.5         |
| 2. Laws and regulations related to financial reporting favor the quality of the audit work  | 3.9         |
| 3. The financial reporting framework in place favors the quality of the audit work  | 4.1         |
| 4. Corporate governance favors the quality of the audit work  | 3.7         |
| 5. Information systems favor the development of audit work  | 4           |
| 6. The timing of financial reporting favors the quality of the audit work   | 4           |

|   |     |
|---|-----|
| 7. Cultural Factors as Awareness of Authority / Business Strategy Conservatization / Management Transparency favor the quality of audit | 3.8 |
| 8. Audit quality in Albania has increased over the last decade  | 4   |
| 9. Audit quality in Albania has decreased over the last decade  | 2.2 |
| 10. The standard applied to the quality of the audit is appropriate   | 3.9 |

*The answers of the Audit Committee members*

Responses from audit committee members indicate that the quality of Likert's used audit is valued at the average value of 4, ie not maximally, but they nevertheless perceive a good level of audit quality. So regarding the way in which the quality of audit in Albania is perceived, the 2 groups of respondents are expressed in the same way, considering the presence of a good quality level and, if not, the maximum.

**The way of showing in practice the quality of the audit**

*Second Research Question:* How does audit quality appear in practice? This question is intended to identify the way in which the quality of the audit is communicated in practice, ie through which behavior, symbols, auditors or audit firms communicate to third parties that they have a proper level of audit quality.

Section 3 of the auditor's questionnaire for the purpose of answering the questionnaire, within this research question. From the evidence gathered, it can be argued firstly that auditors believe that instruments for communicating the presence of audit quality are used by auditors or audit firms, considering the Likert 1-5 scale, with an average value 4. As far as the most commonly used mechanisms for communicating this information to third parties are that these are mostly accomplished through the promotion of personal skills, competences and knowledge, followed by rigorous staffing processes for audit societies and involvement of partners during the phases of audit. It is important to note that because of the sample's susceptibility limit in this study, with all the many and varied attempts to get answers, the analysis of some of the results is largely descriptive in nature. However, within these limits, this study is interesting and important to be considered, as it provides some audit evidence of audit quality, a part of the overall audit system that is not easy to penetrate and which is not widely covered in previous searches.

**3. Key Findings and Recommendations**

The following outlines the findings on the results of this study regarding the perception of the quality of audit quality by key stakeholders in the audit process, and how it is presented by auditors / audit firms in practice.

*Audience Quality perceived*

Evidence on the first research question reflected that the participants in the audit market, overlooked in this matter, think that there is a good level of audit quality

using the Likert 1 to 5 assessment scale, the average rating being 4 . This assessment represents the same average trend for the 2 groups surveyed on this topic, the auditors and the Audit Committee members.

Aspects that are perceived to be of a higher quality are those related to the individual characteristics of the auditor, such as the recognition of client business activity, professional competence, independence, etc. Positive assessment also assumes aspects related to audit engagement, in particular it is perceived that the audit is carried out in accordance with the requirements of law, regulations and professional and ethical standards, the proper audit documentation is kept and the methodology is adapted to the relevant normative developments. Contextual aspects of audit engagement result to have a lower impact on perceived audit quality. In particular, it is perceived that business practices, trade law, corporate governance, have less impact on the quality of perceived auditing. This means that the environment associated with the client's audit firm does not favor a high quality of audit. This finding may be a consequence of the cultural aspects of the audited companies themselves, as well as a relatively short history of the presence of external audit practice in Albania. It is appropriate to sensitize the opinion of partners or management of companies that are subject to external audit so that they consider external audit as an additional opportunity to improve aspects of the business activity being exercised and to promote business of them through the audit report. This would favor a climate of auditing-audit collaboration, with positive impacts on audit quality.

#### *The way in which the quality of the audit is shown in practice*

From the collected evidence, from the group of respondents to the issue in question, EDF, it turns out that instruments for communicating the presence of audit quality are used by auditors or audit firms, considering the values at Likert scale 1-5, with a value average 4. The most useful mechanisms used to communicate this information to third parties are the promotion of personal skills, competences and knowledge. Also the quality of audiis promoted through the rigorous personnel attrition processes for audit societies and the involvement of partners during various audit phases.

According to the surveyed, instruments to show the presence of a suitable audit quality are sufficiently used by the auditors / audit firm, but of course there are room for improvement. It is appropriate, based on the evidence that has resulted, that the auditor processes ongoing work reports during the audit, as well as increases the communication between the auditor and the client company. As a result, these can also be considered as recommendations for stakeholders in the context of improving the quality of the audit.

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