

## **THE EFFECT OF AGENCY RELATIONS ON THE INDEPENDENCE OF EXTERNAL AUDITOR: AN EMPIRICAL STUDY FROM LIBYA**

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### **Abstract:**

The objective of this research is to provide empirical evidence about the relationship between the strength of the client on the independence of the auditor. To provide empirical evidence about the sources power of the auditor and the independence of the auditor. To provide empirical evidence about the auditor and client relation conflict the independence of the auditor in the shadow of agency theory, in Libyan environment.

To achieve this goal the researchers designed a questionnaire to distribute to external auditor in Libya, due to similarity of study population and homogeneity had been chosen a random sample. The respondents were 75 auditors. The objects are 60 audit.

The variables observed are auditor's independence as Dependent Variable, and 3 independent variables they are: Strengths Sources of Client (X1), Sources Power of Auditor (X2),

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and Conflict between Auditor and Client (X3). Regression analysis is statistical tools used to solve the research problem.

Results of data analysis showed that the first hypothesis, i.e.= "The pressures of the client of the institution, negatively affects the independence of the external auditor" is supported. The second hypothesis, i.e.= "The sources power of the auditor, positively affects of the auditor independence" is also supported, and the third hypothesis, i.e.= "The conflict between the auditor and client, negatively affects the independence of the Auditor" is supported.

**Key Words:** *Auditor's Independence, Strengths Sources of Client, Sources Power of Auditor, Conflict between Auditor and Client.*

#### **المخلص:**

هدفت هذه الدراسة إلى: تقديم الأدلة التجريبية حول العلاقة بين مصادر قوة العميل وأثرها على استقلالية المراجع الخارجي. تقديم الأدلة التجريبية حول مصادر قوة المراجع واستقلالية المراجع الخارجي. تقديم الأدلة التجريبية حول علاقة الصراع بين المراجع والعميل على استقلالية المراجع في ظل نظرية الوكالة في البيئة الليبية. ولتحقيق هذا الهدف قام الباحثان بتصميم استبانة تم توزيعها على عينة الدراسة، حيث يتكون مجتمع الدراسة من مراجعي الحسابات في ليبيا، ونظراً لتشابه مجتمع الدراسة وتجانسه قد اختيرت عينة عشوائية بلغ عددها (75) مراجعاً، وقد كان عدد المستجيبين من العينة 60 مراجعاً من مراجعي الحسابات.

وكانت متغيرات الدراسة: استقلال المراجع كمتغير تابع، وثلاثة متغيرات مستقلة هي: مصادر قوة العميل (1×)، مصادر قوة المراجع (2×)، والصراع بين المراجع والعميل (3×). وقد تم استخدام التحليل الوصفي في حل مشكلة البحث، وقد أظهرت الدراسة النتائج الآتية: أن ضغوطات عميل

المؤسسة تؤثر سلباً على استقلال المراجع الخارجي، وأن مصادر قوة المراجع تؤثر بشكل إيجابي على استقلال المراجع، كما أن الصراع بين المراجع والعميل يؤثر سلباً على استقلال المراجع.

## 1. Research Framework

### 1.1. Introduction

The potential for auditor-client conflict is a source of much concern and speculation (Knapp, 1985). In fact, there is an evidence suggesting that conflicts between auditor and client are occurring with increasing frequency (Gul, 1991). Results of work by Kiridaran and others suggest that auditor fee dependence on the audit client is associated with earnings management via abnormal and is a potential threat to auditor independence for small banks (Kiridaran, et al., 2010). These pressures may take a variety of forms but generally hinge on issues related to the need to make adjustments to the financial statements, the propriety of the clients' accounting principles and the adequacy of disclosures in the financial statements. Audit financial statements are the outcome of a resolution process (Goddwing, 2002) involving negotiation between the auditor and client the way that auditor deals with issues under dispute can have a significant effect on audit independence and on the credibility of financial statements. There is an ongoing drive to improve the integrity of financial reporting by enhancing extant regulation on external auditor independence (Kenny and Ian, 2008).

These studies review the agency relationship as a relation between both parties or more, on which the agent should be assigned for taking decision on behalf of the principal (Stephen A.Ross, 1973). The essence of the problem emerges in the relation emerges as that the agent will consider in his decisions in favor of owners interests, but he will consider the favor of himself (Herbert ,1986) in the field of the agency relationship, the general studies aim to induce the agents so that their decisions should be in favor of the owners. It means this relation between the boss (client) and employees (auditor) is that everyone has own interest. Every agent is pushed to achieve his personal interest even on the account of the other agent's interests (Eugene, F. , 1980). Both the principal and agent are risk neutral or risk adverse. The agent wishes to minimize his effort and increase his revenues. The behavior of each of the agent (auditor) and principal (management) are wise and keen (Wool J. , 1981)

The purpose of this study is to examine the agency's relationship between the auditor and client, and the impact of this relationship and conflict on the independence of the auditor, how the auditor resists these pressures and find out the problems of this relationship and the statement of the inevitability of that relationship that depends on agency theory in the Libyan environment. By definition, agency theory attempts to describe a relationship where one party (the principal) delegates work to another (the agent). Furthermore, it is concerned with resolving the

problems in a relationship with conflict of interests and risk sharing when attitudes toward risk diverge (Kim, 2010).

According to Kim (2010), agency theory focuses on resolving two problems occurring in the agency relationship: agency problems and the problem of risk sharing. An agency problem occurs when the interests of the principal and agent conflict and it is difficult or expensive for the principal to monitor the agent's actions. On the other hand, a problem of risk sharing occurs when the principal and agent have different attitudes towards risk.

## **1.2 . Research Problem**

External audit profession occupies a prominent place in the economic environment. That for the importance of its role in the service to many users of financial information, where the role of the external auditor is to express an independent opinion for legitimacy and integrity of financial reports that are prepared by the administration, which guarantees the client and other interested parties in institution to possibility valuate performance of the management.. That independence is one of the most important- consideration which a necessary condition to ensure confidence in the opinion of the auditor. An analyzer for these relations inside that environment find that, they consist of a series of relationships agency and the conflict between them, which may affect the auditor commitment of the standards of the even though it is not a party to each other. The conflict between the client and auditor effects

independence is the crucifixion of the research problem, how can keep auditor to independence in the shadow of those relationships and this conflict.

**Therefore the research problem can be expressed by the following Questions:**

- 1- Does strength of the client of the institution affect independence of auditor?
- 2- Do the sources of the auditor affect their independence?
- 3- Does the conflict between the auditor and client affect the independence of the auditor?

### **1.3. Objectives of the Study**

- 1- To provide empirical evidence about the relationship between the strength of the client and the independence of the auditor.
- 2- To provide empirical evidence about the relationship between the sources of the auditor and the independence of the auditor.
- 3- To provide empirical evidence about the relationship between the auditor and client conflict and the independence of the auditor.

### **1.4. Contributions to the Study**

#### **a. For Literature**

1. This study extends previous research to Libyan settings because there is a of lack research using agency theory to investigate about it, the result of this study may have implication for the accounting and auditing literature.

2. This study is a pioneer research on the independence of the auditor in the Libyan environment.

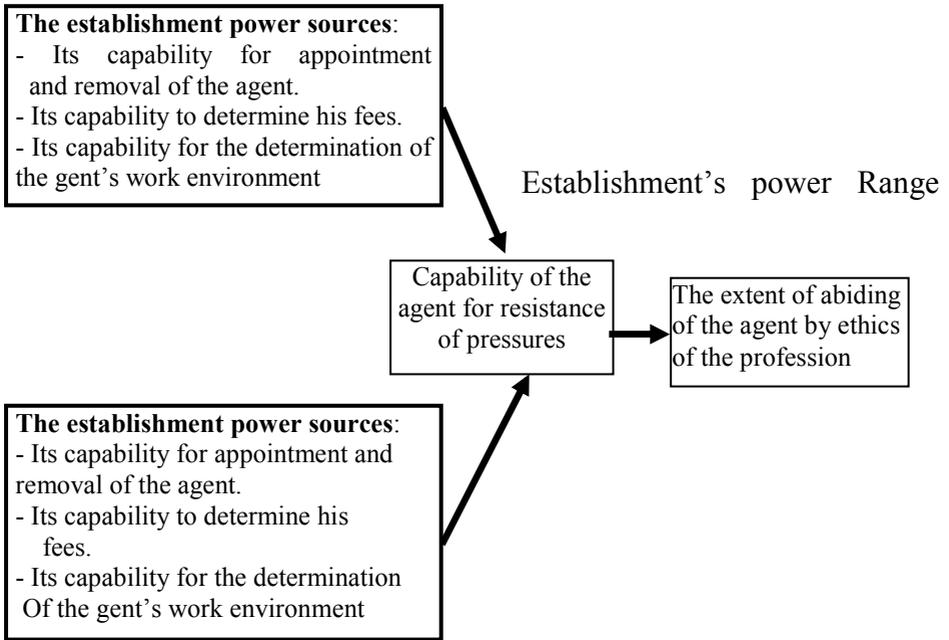
**b. For Practice**

1. To give recommendations to auditing regulator in Libya in enhancing auditing quality in Libya.

2. To show how far the auditor commitment to standards of the profession in Libya, which is considered the most important of independence, raising the confidence of the public users of the outputs of the profession. In the efficiency of its members and also increase respect for this public to the profession and its members.

**2. LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT**

Barlev and Goldman, (1975) asserted that the agent's independence as a function of his capability regarding resistance of pressures. This capability will be determined according to balance of powers between each of the establishment and agent, where each of them owns the powers resources. If the sources of the establishment's power dominate, the agent will lose his independence and vice versa. The following figure illustrates:



**Agent's Power Range  
(Barlev and Goldman, 1975)**

The auditor loses to his independence occurs if the probability of increased exposure to the pressure and increased the strength of that pressure and decreased ability to resist these pressures. (Bar-Lev, and Goldman, 1975)

Knapp (1985) examined how certain contextual factors in audit client conflict affect the perceived ability of auditors to resist client pressure .The results indicate that a client in good financial condition is perceived as being more likely to obtain its preferred outcome to an

audit conflict than a client in poor financial condition. Gul, 1991 examined the auditors' ability to resist management pressure in an audit conflict situation. The Results supported the hypothesized effects of these variables and, in particular, that size of audit fee affects perceptions of the auditors' ability to resist management pressure regardless of the other variables.

Judy and Gul, 1996 have investigated the interaction effects of locus of control, a personality variable, and ethical reasoning on the behavior of auditors in an audit conflict situation. The Results showed that ethical reasoning moderated the relationship between locus of control and auditors' ability to resist management pressure and other researchers perceives that there are some factors affecting the independence and neutrality of external auditor, such as: auditing fees, the auditor may obtain some financial benefits from his client, the long engagement period with his client and introducing managerial and consulting services to him, (Jarboa, 2004).

Ken, Randel and his coworkers investigated auditor independence and audit quality in auditor-client negotiation over financial reporting issues using Taiwan data (Ken, et al., 2005). They researcher found a significant negative relation between non audit services and the extent of client agreement with the auditor over financial reporting issues, consistent with non-audit services reducing independence. In another study by Shen and others, it was found that

found that the qualified audit opinions and alien factor affect the switch of auditors. They hold that the qualified opinions embody the interest conflict between listed companies and auditors (Shen, et al., 2006).

Kadem (2007) has examined the factors affecting the independence of the auditor, which are classified into objective factors and other personal which affect to varying degrees on his independence and this study concluded that the auditing standards and professional behavior are the most impact factor on the independence of the auditor and that the integrity, honesty and truthfulness of the qualities that must be provided by the independence auditor.

Kenny Z and Ian A, ( 2008) found that U.K. auditors perceive specificity of accounting standards, auditor tenure MAS and the competition is less likely to affect decisions as to whether or not to accept clients' preferred accounting treatments than do their Chinese counterparts. Kiridaran, Gopal and Lobo, 2010 examined auditor independence in the banking industry by analyzing the relation between fees paid to auditors and the extent of earnings management through loan loss provisions LLP. Result suggest that auditor fee dependence on the audit client is associated with earnings management via abnormal LLP and is a potential threat to auditor independence for small banks. (Ole and John Langi, 2010) results provide no evidence that auditors

compromise their independence through fee dependence. These results are robust to controlling for the expected portion of fees.

According to Al-Raheedy (2012) the independence conditions for the external accounting auditors in the state of Kuwait are not available, from the point of view of the group, included in accounting auditors, the financial statements users, the control and supervision parties), and the control and supervision parties are the more effective regarding this opinion, and there are impediments to provide the independence conditions for the external accounting auditors in the state of Kuwait. The most parties that support this opinion are the control and supervision parties on the profession.

Nasren Mansor (2013) has investigated the impact of external auditor rotation on independence principle. It appears, from the findings, that the supervision of the Audit Committee to discuss the external auditor in the problems encountered during the audit process of the most important factors determining the role of the commission, in addition to the design and implementation of financial information systems to the customer is one of the prohibited services and auditor had to change in order to preserve its independence.

## **2.1 Grand Theory:**

During early 1970s particularly in U.S.A studies emerged dealing with the agency theory. These studies concentrate on the agency relations within the organizational structure, whereas every

administrative level is considered as a base for the lower levels and superior levels.

There are various theory definitions; some authors (Richard M. Steers, 1982) think that: “it is a set of facts indicating several variables. Internal consistency that means non- contradiction of its given aspects, or hypothesis and their consistency with logic, the external consistency means that non- contradiction of the theory with the realistic events, Generalizability, scientific parsimony, and last verification or possibility of ensuring the correctness of its results, whereas without this possibility, it is impossible to determine the usefulness of this theory. No doubt that the theory is classification for knowledge, whereas from one hand it aids in organizing information about a certain topic, and on the other hand it determines the un- known research fields, that need more concentration. The agency theory evolved as a theory that interprets and forecasts the behavior of both agency parties (The agent and their interests, the desire of each of them to investigate his revenues, and each of them should be keen and wise).

There were several studies and publications related to the agency theory in the second half of this century, whereas on its beginning prevails the free economy. These studies reviewed the agency relationship as a relation between both parties or more, on which the agent should be assigned for taking decision on behalf of the principal (Stephen A. , 1973)The essence of the relevant problem emerges as a

fact that during separation of the administration from the ownership, it is not expected, that the agent will consider in his decisions the favor of owners interests, but he will consider the favor of himself (Herbert G.Hunt, 1986)in the field of the agency relationship, the general studies aim to induce the agents so that their decisions should be in favor of the owners.

Every agent is pushed to achieve his personal interest even on the account of the other agents' interests (two agents may be allied together against the rest of the agents), with the presence of corporate interest between them, which is the existence of the organization whereas it is a source of acquiring of their revenues (Eugene fama, 1980).Some authors (Baiman.S, 1982) confirm this meaning, whereas they decide that the establishment should not be viewed as an independent entity, but as a set of relations between the agents in it, whereas each of them was pushed to achieve his personal interest, hence it is important to make balance between those contradicting interests. As various theories, the agency theory is based on certain hypothesis, from which several problems emerge resulting in costs. There were suggested solutions to these problems, as well there were criticisms and contributions.

The researchers will deal with these points:-

**Assumption of Agency Theory and its Reflections in the Accountancy Fields:**

The agency theory was based on several certain hypotheses. This theory should not be dealt with as separate from its hypothesis, whereas its limits to its outcomes, this hypothesis include:

1- Individuals want to achieve their personal interests and maximize their welfare. (Jensen, et al., 1976)

2- The competitive circumstances are prevailing in the economic environment in which the organizations are working; hence these organizations should achieve their objectives with the minimum costs, to enable them to survive (John K. Galbraith, 1973)

3- The organization represents a market in which the principal negotiates with the agents until; their desires and interests meet (Eugene fama, 1980) .this market is characterized by complete competition.

4- The information market is characterized by efficiency in conveying information; this means that the agent and principal information will be relatively close to each other's.

5- The increase in organizations volume, will lead to increase in the privileges of separation of management from owner, also increase in agency cost born by the organization (Jensen, et al., 1976).

6- This hypothesis was criticized on the basis that in the small organizations, there is no clear separation between the management and ownership, and the information market is not distinguished by

efficiency, pursuant to this , the agency problems will increase, due to lose in the control system, that result in raising the agency costs. (John.H.Hand and others, 1982)

7- To enable the principal to determine the agent revenues, it is important to depend on the reports of performance, and information about the ex- agent (Fox R.B, 1984).

As long as the relationship grew up between the auditor (agent) and the client (principal) and this relation cannot be repealed because of their need for the existence of audit services (agent) and the client (principal) There are other assumptions about existence of this relationship, whose several parties and objectives involve the agency relationship emerging between one principal (client) and one agent (external auditor). Traditional agency theory has been applied to this relationship (Almer, et al., 2005). A strict view of this theory suggests that the relationship between the principal and the agent is controlled by incentives and the availability of information. Both parties act in their own self-interest; where the principal achieves profit and growth. The agent receives compensation for the work performed, so in this research the auditor As a (the agent) receives compensation for the work, the client works for the achieve profit of the firm (the principal).

## **2.2 Hypotheses Development**

It is assumed that when delegating decision-making power to one party, as suggested in agency theory, the agent is motivated to agree to

be monitored if the benefits from such activities exceed the related costs. This hypothesis is applicable to all co-operative relationships in any organization, not only relationships between owners and managers, but also in relationships between employers and employees, creditors and shareholders, different levels of management in companies and government and taxpayers. (Kim, 2010).

For example (Knapp, 1985) asserts that with highly routine or structured auditing principles the firm (client) would be less likely to pressure the auditor. They also argue that the less structure inherent in the relevant technical standard, the less likely the auditor is to comply with management demands. One of the few empirical studies of audit conflict (Knapp, 1985) yielded results generally supporting the Nichols and Price assertion concerning the likelihood that management would attempt to influence its audit firm's professional judgment .the hypothesis stated below pertains instead to the likely outcomes of such conflict.

**H1-The Pressures of the client of the institution, negatively affects the independence of the external auditor.**

As related to agency theory there is in line correlation that every agent (auditor) is pushed to achieve his personal interest even on the account of the other agents' interests (two agents may be allied together against the rest of the agents), with the presence of corporate interest between them, which is the existence of the organization whereas it is a

source of acquiring of their revenues (Eugene Fama, 1980). Some authors (S.Baiman, 1982) confirm this meaning, whereas they decide that the establishment of the interests should not be viewed as an independent entity, but as a set of relations between the agents (auditor) and principal (client) in it, whereas each of them was pushed to achieve his personal interest, hence it is important to make balance between those contradicting interests.

The extant research literature documents the impact of various contextual factors on perceptions of audit independence. In particular, research has investigated the effects of audit fees, MAS, audit firm size, audit market competition, accounting standard specificity and audit tenure on perceptions of auditor ability to resist client pressure (Kenny Z and Ian A, 2008). In prior to studies on the effects of MAS, size and competition on perceptions of auditor independence, the linkages to the size of audit fee have been tenuous and speculative (Gul, 1991). There is therefore a need for evidence on whether the size of audit fees' would affect perceptions of auditor independence, regardless of the existence of MAS, the size of the audit firm and the level of competition. It is likely that the auditor is relatively more dependent on a client when a significant proportion of the audit firm's fees come from that client. This may reduce the audit firm's ability to withstand pressure as a result of an audit conflict, in turn impairing perceived independence. In these circumstances it is possible that the auditor will resolve the conflict in

favor of the client. Alternatively, if the audit fees constitute an insignificant proportion of the audit firm's fees the auditor is less dependent on the client. This will improve the auditor's ability to withstand management pressure and it is less likely that the auditor will resolve the conflict in favor of the client.

**H2-The sources power of the auditor, positively affects of the auditor independence.**

According to Kim (2010), agency theory focuses on resolving two problems occurring in the agency relationship: agency problems and the problem of risk sharing. An agency problem occurs when the interests of the principal and agent conflict and it is difficult or expensive for the principal to monitor the agent's actions. On the other hand, a problem of risk sharing occurs when the principal and agent have different attitudes towards risk. Based on the Windsor and Ashkanasy models, it is argued that auditor independence is affected by moral reasoning development and personal beliefs embedded in the preconscious and activated by ethical dilemmas (Windsor and Ashkanasy, 1995). Thus, when auditors are pressured by client management bargaining power, the extent to which personal beliefs affect their independence is determined by the auditor's level of moral reasoning development. The extant research literature documents the impact of various contextual factors on perceptions of audit independence. In particular, research has investigated the effects of audit

fees, MAS, audit firm size, audit market competition, accounting standard specificity and audit tenure on perceptions of auditor ability to resist client pressure (e.g., Knapp, 1985; Kenny and Ian, 2008). Kenny and Ian have investigated the influence of non-audit fees and client pressure on external audit evidence gathering choices and they found that when significant non-audit services are provided, client pressure increases the extent of internal audit reliance significantly.

**H3-The conflict between the auditor and client, negatively affects the independence of the Auditor.**

**3. Research Methodology**

The current research was based on a survey; A questionnaire will be distributed to external auditor in Libya. This form of questions has been chosen to investigate a list of issues about the auditor-client negotiation relationship. The independence of the external auditor and through the questionnaire that had been prepared for these purpose .The researchers used the statistical program (SPSS). The research applies quantitative approach to determine the relationship and the conflict between the independent variable and the dependent variable. Experience to determine causation. Quantitative research is all about measuring the relationships between variables. Different designs and vary in the quality of evidence, which states the relationship between cause and effect between variables. Empirical studies provide the best evidence about discovering and impacting of some factors on auditing

profession. The research used a convenience sampling because there is no an audit guide in Libya (DATA BASE). The researchers selected some auditors to be this is a sample study to conduct field research.

**3.1. Data collection:**

The questionnaire was designed, including four categories:

**Section I:** this section was to explore the independence of the external auditor. It includes 7 Statements.

**Section II:** This section was to explore the pressures faced by the auditor . It includes 8 statements.

**Section III:** This section was to explore how to confrontate the pressures that incurits the auditor. It includes 8 statements.

**Section IV :** This section was to explore the exposure of the interest of the auditor. It includes 8 statements.

Thus, the total number of paragraphs in the questionnaire is 31. Its kind of a closed questionnaire, and presented in accordance to the Likert Scale with five dimensions.

Categories	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree
Number	1	2	3	4	5

**3.2. Variable Measurement: dividing the variable of the study to:**

***Dependent Variable:***

The auditor independence (Barlev and Goldman, 1975; Salem1990). The concept of auditor independence is integral to

professional codes of ethics and standards which guide auditors in practice (Ashkanasy and Windsor, 1995).

***Independent variables:***

***The first independent Variable is the strengths of the client.***

The right of client established in the appointment and removal of auditor and determines his remuneration is a right authorized by law, measured strongly threats to isolate the auditor and their ability to delimitation negotiation of the fees (Barlev and Goldman, 1975).

***The second independent variable is the power source of the auditor.***

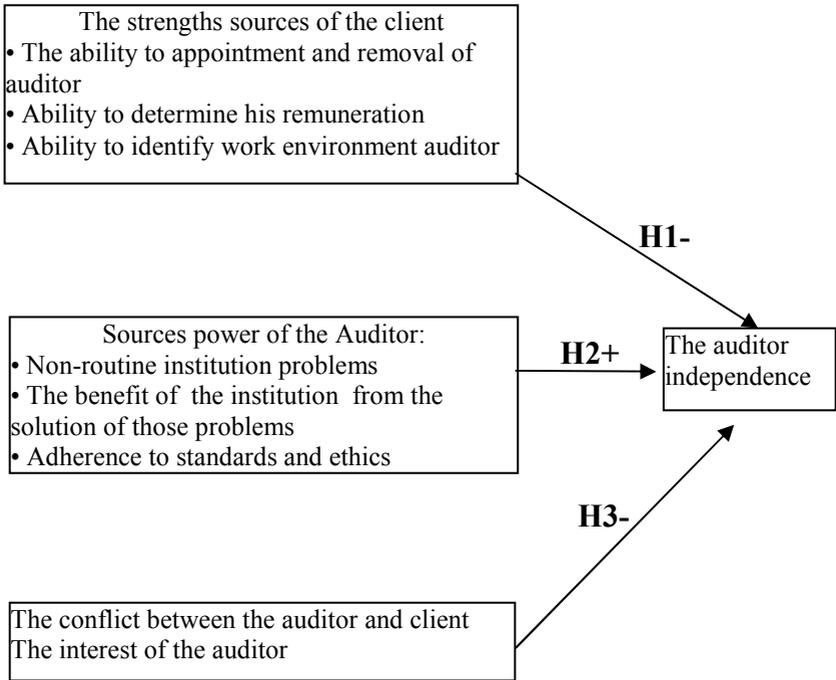
These are the extent of auditor independence materially from the institution and measure it by what got of the fees from the institution to office total revenue and the extent hang the auditor over the ethics and conduct and professional standards and measure by the extent of the severity of the sanctions in case of breach of ethics and conduct and standards of profession (Barlev and Goldman, 1975; Salem 1990).

***The third independent variable is the conflict between the auditor and client***

This variable is measured by the interest for the auditor (Salem, 1990). The variables measure them accordance to the Likert Scale with five dimensions.

**Theoretical Model:**

Hypotheses proposed by this study can be summarized into theoretical model as follows:



**(Theoretical Model)**

**3.3. Data Analysis:**

Analysis is the application of reasoning to understand and interpret the data that have been collected about the subject (Zikmund 2000). From 75 questioners distributed to the external auditor , only 60 were returned and could be processed. Here are some results of data processing which include reliability and validity, descriptive statistics, fit model test (R Square), F-test or ANOVAs, and test of hypothesis

### **3.3.1 Reliability and Validity:**

#### **Reliability:**

Reliability refers to the precision of measurement (Hair, 1998). Reliability is synonymous with other terms such as dependability, stability, consistency, predictability and accuracy. Therefore, this study only examined the consistency of the scale Cronach's alpha which was used to examine the consistency of the entire scale. In this study, the desired cut-off for Cronbach's alpha was 0.70 because this value is the accepted level of internal consistency reliability (Hair et al. 1998). Further, internal consistency was also assessed by looking at the item to-total correlation. Thus, in this study the desired cut-off for item-to-total correlation and inter-item correlation were 0.50 and 0.30 respectively. Therefore, any items below the cut-off values were dropped from analysis. The nine items that were dropped as described earlier had item-to-total correlations and inter-item correlations below the desired cut-off.

Reliability estimates for the measures of variables are computed using the software package SPSS version 11. 5. The results are presented in the Table 1 as follows:

**Table 1**  
**Reliability of Instrument**

<b>Variable</b>	<b>Crombach Alpha (Counted)</b>	<b>Crombach Alpha (Table)</b>	<b>Status</b>
Auditor Independence (Y)	0.986	0.70	Reliable
Strengths Sources of Client (X1)	0.953	0.70	Reliable
Sources Power of Auditor (X2)	0.975	0.70	Reliable
Conflict Between Auditor and client (X3)	0.969	0.70	Reliable

**Source : data processed, 2016**

Results output of SPSS in Table 1 shows that the value of counted Cronbach alpha for all variables are between **0.953-0.986** or have the value higher than 0.70. Therefore, the instrument used to measure all these variables is reliable.

**Validity:**

Validity is the extent to which a scale or set of measure accurately represent the concept of interest. Validity is defined as the extent to which any measuring instrument measures what it is intended to measure (Hair et al. 1998).

In this study, construct validity was examined through both content and construct validity. As content validity has been described in the questionnaire design section, the discussion in this section is limited to the statistical analysis undertaken to examine construct validity. The significance test is carried out by comparing the value of r-counted with r table with degree of freedom (df) In this research df = 60, then the r-

table used as the standard comparison to  $r$ -counted is 0.28 (the one-sided test). The conclusion taken is if  $r$ -counted is higher than the value of  $r$  table it means that this instrument is valid.

Table 2  
Validity of Instrument of Dependent Variable (Y)

Indicator	Corrected Item- Total Correlatio( $r$ -counted)	$r$ - table	Status
Yi	0.951	0.28	Valid
Yii	0.932	0.28	Valid
Yiii	0.950	0.28	Valid
Yiv	0.955	0.28	Valid
Yv	0.956	0.28	Valid
Yvi	0.926	0.28	Valid
Yvii	0.961	0.28	Valid
Yviiib	0.942	0.28	Valid
Yviiic	0.937	0.28	Valid

Source : data processed, 2016

The validity for the measurement questionnaire of the Auditor Independence (Y) as in Table 2 shows (taken from SPSS output validity test— *corrected item-total correlation*) that all  $r$ -counted are between **0.926-0.961** or higher than  $r$ -table. Therefore, all questions (Yi – Yviiic) which construct on instrument for Auditor Independence (Y) are valid.

Table 3

Validity of Instrument of Independent variables (X1,X2,xX3)

Indicator X1	Corrected Item-Total Correlation (r-counted) X1	Indicator X2	Corrected Item-Total Correlation (r-counted) X2	Indicator X3	Corrected Item-Total Correlation (r-counted) X3	r-table	Status
X1i	0.829	X2i	0.919	X3i	0.886	0.28	Valid
X1ii	0.907	X2ii	0.918	X3ii	0.920	0.28	Valid
X1iii	0.833	X2iii	0.892	X3iii	0.929	0.28	Valid
X1iv	0.921	X2iv	0.927	X3iv	0.913	0.28	Valid
X1v	0.816	X2v	0.948	X3v	0.913	0.28	Valid
X1vi	0.903	X2vi	0.963	X3vi	0.893	0.28	Valid
X1vii	0.866	X2vii	0.940	X3vii	0.890	0.28	Valid
X1viii	0.935	X2viii	0.927	X3viii	0.956	0.28	Valid

Source : data processed, 2016

The validity for the measurement questionnaire of the Strengths Sources of Client (X1) as in Table 3 shows (taken from SPSS output validity test -- *corrected item-total correlation*) that all r-counted are between **0.816-0.935** or higher than r-table. Therefore, all questions (X1i – X1viii) which construct on instrument for Strengths Sources of Client (X1) are valid. And the validity for the measurement questionnaire of the Sources Power of Auditor (X2) shows (taken from SPSS output validity test -- *corrected item-total correlation*) that all r-counted are between 0.892 -0.963 or higher than r-table. Therefore, all questions (X2i –

X2viii) which construct on instrument for Sources Power of Auditor (X2) are valid.

Also the validity for the measurement questionnaire of the Conflict between Auditor and Client (X3) shows (taken from SPSS output validity test -- *corrected item-total correlation*) that all r-counted are between **0.886-0.956** or higher than r-table. Therefore, all questions (X3i–X3viii) which construct on instrument for Conflict between Auditor and Client (X3) are valid.

**3.3.2. Descriptive Statistics**

Descriptive statistics of responden perception will be presented as follows:

Table 4  
**Descriptive Statistics Responden Perception on Independence of Auditor (Y)**

	N	Minimum	Maximum	Mean	Std. Deviation
yi	60	2.00	5.00	4.2667	.82064
yii	60	1.00	5.00	3.6000	.92425
yiii	60	1.00	5.00	3.4667	1.12697
yiv	60	1.00	5.00	3.3000	1.19745
yv	60	1.00	5.00	4.1333	.96492
yvi	60	1.00	5.00	4.0000	1.16445
yvii	60	1.00	5.00	3.5667	1.25370
yviiib	60	2.00	5.00	4.0667	.86095
yviiic	60	1.00	5.00	3.6667	1.05230
Audior Indebadence	60	1.19	5.00	3.7908	.97962
Valid N (listwise)	60				

Source : data processed, 2016

Table 4 shows that the respondent's response to the Independence of Auditor (Y) are in average point of **3.7908** which means that almost all the respondents perceive that the Independence of Auditor (Y) are not too high or not too small (medium). Although, there are the respondents who consider that the Independence of Auditor (Y) is very small and that is in minimal value of **1.19** and also there are the respondents consider that the Independence of Auditor (Y) is very high that is the maximal value of **5**. With the average value of **3.7908**, it means that the Independence of Auditors has to be increased so that they could work more objective in conducting audit work.

Table 5

Descriptive Statistics Responden Perception on Strengths Sources of Client (X1)

	N	Minimum	Maximum	Mean	Std. Deviation
x1i	60	1.00	5.00	3.6000	.82749
x1ii	60	1.00	5.00	2.9833	.94764
x1iii	60	1.00	5.00	3.4500	1.09583
x1iv	60	1.00	5.00	3.0000	.93881
x1v	60	1.00	4.00	2.3333	.75165
x1vi	60	1.00	4.00	2.0000	.73646
x1vii	60	1.00	4.00	2.8833	.69115
x1viii	60	1.00	5.00	2.8167	.87317
Sources of Client	60	1.13	4.63	2.8857	.75267
Valid N (listwise)	60				

Source : data processed, 2016

Table 5 shows that the respondent's response to Strengths Sources of Client (X1) are in average point of **2.8857** which means that almost all the respondents perceive that Strengths Sources of Client (X1) are

not too high or not too small (medium). Although, there are the respondents consider that Strengths Sources of Client (X1) is very small that is in minimal value of **1.13** and also there are the respondents who consider that Strengths Sources of Client (X1) is very high that is the maximal value of **4.63** . With the average value of **2.8857**, it means that the Strengths Sources of Clients (X1) has to be maintained or lowered so that the clients are not too much interfere auditor in conducting audit work.

**Table 6**

**Descriptive Statistics Responden Perception on Sources Power of Auditor (X2)**

	N	Minimum	Maximum	Mean	Std. Deviation
x2i	60	1.00	5.00	4.0000	.86358
x2ii	60	3.00	5.00	4.4000	.71781
x2iii	60	2.00	4.00	3.1333	.89190
x2iv	60	2.00	5.00	3.9333	.82064
x2v	60	1.00	5.00	4.1000	.95136
x2vi	60	1.00	5.00	4.1000	1.08456
x2vii	60	2.00	5.00	3.9667	.88234
x2viii	60	3.00	5.00	4.2333	.67313
Sources Power of Auditor	60	1.88	4.88	3.9867	.80133
Valid N (listwise)	60				

Source: data processed, 2016

Table 6 shows that the respondent's response to Sources Power of Auditor (X2) is in average point of **3.9867** which means that almost all the respondents perceive that Sources Power of Auditor (X2) is quite

high. Although, there are the respondents who consider that Sources Power of Auditor (X2) is very small that is in minimal value of **1.88** and also there are the respondents consider that Sources Power of Auditor (X2) is very high that is the maximal value of **4.88**, With the average value of **3.9867**, it means that the Sources Power of Auditor (X2) have to be maintained so that they could work more objective in conducting audit work and be more independent.

Table 7  
Descriptive Statistics Responden Perception on Conflict Between Auditor and Client (X3)

	N	Minimum	Maximum	Mean	Std. Deviation
x3i	60	1.00	4.00	2.0333	.84305
x3ii	60	1.00	4.00	1.9667	1.13446
x3iii	60	2.00	5.00	2.8833	.78312
x3iv	60	1.00	4.00	3.0667	.91812
x3v	60	2.00	5.00	3.4667	.87269
x3vi	60	1.00	5.00	3.6667	1.05230
x3vii	60	2.00	5.00	3.4500	.79030
x3viii	60	2.00	5.00	3.7167	.92226
Conflict Between Auditor and Client	60	1.50	4.63	3.0342	.83531
Valid N (listwise)	60				

Source : data processed, 2016

Table 7 shows that the respondent's response to Conflict Between Auditor and Client (X3) is in average point of **3.0342** which means that almost all the respondents perceive that Conflict Between Auditor and Client (X3) are not too high or not too small (medium). Although,

there are the respondents who consider that Conflict Between Auditor and Client (X3) that is very small that is in minimal value of **1.50** and also there are the respondents consider that Conflict Between Auditor and Client (X3) is very high that is the maximal value of **4.63**. With the average value of **3.0342**, it means that the Conflict between Auditor and Client (X3) had to be lowered so that the audit work could produce objective result without any manipulation because auditor has independency to work his task and the audited company doesn't interfere the auditor in audit work in the company.

### 3.3.3. Test of Fit Model (Adjusted R Square)

To check fit the model or the independent variables in explaining variations of the dependent variable, it could be known from the value of the determination coefficient that is produced. Results is presented to the table 8 as follows:

Tabel 8  
Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.994(a)	.989	.988	.10643	1.010

a Predictors: (Constant), Conflict Between Auditor and Client, Strengths Sources of Client, Sources Power of Auditor

b Dependent Variable: Auditor Independence

Source : data processed, 2016

Table 8 above shows that the value of the determination coefficient or Adjusted R Square is **0.988**, it means that the variation of dependent variable could be explained of **98.8 %** by the entire free variable (simultaneously). The model is fit. Meanwhile, the rest of them (**100% - 98.8% = 1.2 %**) is explained by other reasons outside the variable that is researched in this study.

**3.3.4. Test of ANOVA (F-Test)**

The further testing is the F test that is testing the influence of the free variable together against the dependent variable. Results are presented in Table 9 as follows:

Tabel 9  
Test of ANOVA (F-Test)

Model	Sum of Squares	df	Mean Square	F	Sig.
1 Regression	55.985	3	18.662	1647.360	.000(a)
Residual	.634	56	.011		
Total	56.620	59			

Source : data processed, 2016

Table 9 shows that the value of F-counted is **1647.360** with p-value of **0.000** or more than **0.05**. Therefore it is concluded that the variable Strengths Sources of Client (X1), Sources Power of Auditor (X2), and Conflict between Auditor and Client (X3), influents together significantly against the dependent variable of Auditor Independence (Y).

### 3.3.5. Hypothesis Test

Hypothesis testing is the use of statistics to determine the probability that a given hypothesis is true.

Results of the Hypothesis Test are tabulated in Table 10.

Table 10  
Results of the Hypothesis Test

Model	Coefficients Unstandardized		Standardized Coefficients	t	Sig
	B	Std. Error	Beta		
1 (Constant)	-.947	.073		-12.924	.000
Sources of Client	-.100	.025	<b>-.077</b>	<b>-3.987</b>	.000
Sources Power of Auditor	1.306	.025	<b>1.069</b>	<b>51.890</b>	.000
Conflict Between Auditor and Client	-.060	.019	<b>-.051</b>	<b>-3.147</b>	.003

Source : data processed, 2016

$$Y=a+b_1x_1+b_2x_2+b_3x_3$$

Where: a=constant

b1-b3= regression coefficients

Y= auditor independence

X1= the strengths sources of the client

X2= sources power of the auditor

X3=the conflict between the auditor and client

H1 will be supported if b1 statistically significant

H2 will be supported if b2 statistically significant

H3 will be supported if b3 statistically significant

The result of the data analysis from the table 10 can be summarized into the equation.

$$Y = (-0.07) + 1,06 + (-0.05)$$

Table 10 shows that t-counted for Strengths Sources of Client (X1) is -3.98 with *p*-value 0.00 lower or “<” than 0.05 that means that the observed effect is statistically significant, the null hypothesis is ruled out, and the alternative hypothesis is valid. Therefore first hypothesis is supported, “. The Pressures of the client of the institution, negatively affects the independence of the external auditor.”. The un-standardized coefficients B to Table 10 above for the independent variable for Strengths Sources of Client (X1) are -0.10. The coefficient is used to know how big Strengths Sources of Client (X1) influents against the dependent variable of Auditor’s Independence (Y). Therefore, Table 10 shows that everyone rise point of Strengths Sources of Client (X1) causes the decline of Auditor’s Independence (Y) for -0.10 points, or it is vice versa.

Table 10 also shows that t-counted for Sources Power of Auditor (X2) is **51.89** with *p*-value 0.00 lower or “<” than 0.05 that means that the observed effect is statistically significant, the null hypothesis is ruled out, and the alternative hypothesis is also valid. Therefore, second hypothesis also is supported, “**The sources power of the auditor, positively affects of the auditor independence.**” The un-standardized

coefficients B to Table 10 above for the independent variable for Sources Power of Auditor (X2) are **1.30**. The coefficient is used to know how big Sources Power of Auditor (X2) influents against the dependent variable of Auditor's Independence (Y). Therefore, Table 10 shows that everyone rise point of Sources Power of Auditor (X2) causes the rise of Auditor's Independence (Y) for **1.30** points, or it is vice versa.

Table 10 also shows that t-counted for Conflict Between Auditor and Client (X3) is **-3.14** with *p*-value 0.00 lower or "<" than 0.05 that means that the observed effect is statistically significant, the null hypothesis is ruled out, and the alternative hypothesis is also valid. Therefore, third hypothesis is also supported, **"The conflict between the auditor and client, negatively affects the independence of the Auditor."** The unstandardised coefficients B to Table 10 above for the independent variable for Conflict between Auditor and Client (X3) are **-.060**. The coefficient is used to know how big Conflict Between Auditor and Client (X3) influents against the dependent variable of Auditor's Independence (Y). Therefore, Table 10 shows that everyone rise point of Conflict Between Auditor and Client (X3) causes the decline of Auditor's Independence (Y) for **-.060** points, or it is vice versa..

#### **4. Discussion:**

##### **4.1 Discussion for Hypothesis 1:**

If it is being seen from the value of regression coefficient in Table 10 for variable Strengths Sources of Client (X1) which is negative,

it means that the higher Strengths Sources of Client (X1) will result the lower Auditor Independence (Y) or the lower Strengths Sources of Client (X1) will result the higher Auditor Independence (Y). It is already in accordance with results of the previous research conducted by Knapp who has found that the client's ability to influence the auditor's judgment decreases so that independence of auditor is increased (Knapp, 1985). When this finding is related to agency theory (summarized by Fox R.B, 1984) there are some points that may be in line those are:

1. The owner (Client) present to the proposed agent (auditor) the contract involving the audit task of the assigned tasks to it, and the method of determination of the assigned tasks to him, and the method of determination of his revenues under various levels to perform these tasks.
2. The agent (auditor) estimates his expected benefits according to stipulation of contract (contract of audit task).
3. The agent (auditor) accepts contraction, if his expected revenue increases than the revenue of alternative opportunity according to the stipulation of the contract.
4. The agent (auditor) will execute the assigned tasks to him during the contractual period.

By comparing the agency theory and the finding of this study it is found that both are in line that the higher Strengths Sources of Client (X1) will result the lower Auditor Independence (Y) or the lower

Strengths Sources of Client (X1) will result the higher Auditor Independence (Y). The higher strength source of client means the client could give more revenue from the contract given than the other so the auditor will execute the assigned to him during contract period to “please” the client.

#### **4.2. Discussion for Hypothesis 2:**

If it is being seen from the value of regression coefficient in Table 10 for variable Sources Power of Auditor (X2) which is positive, it means that the higher Sources Power of Auditor (X2) will result the higher Auditor Independence (Y) or the lower Sources Power of Auditor (X2) will result in the lower Auditor Independence (Y). It means that it is already in accordance with results of the previous research conducted by (Ashkanasy and Windsor, v1995) who argued that auditor independence is affected by moral reasoning development and personal beliefs embedded in the preconscious and activated by ethical dilemmas. Thus, when auditors are pressured by client management bargaining power, the extent to which personal beliefs affect their independence is determined by the auditor’s level of moral reasoning development.

When this finding is related to agency theory there is in line correlation that every agent (auditor) is pushed to achieve his personal interest even on the account of the other agents' interests (two agents may be allied together against the rest of the agents), with the presence of corporate interest between them, which is the existence of the

organization whereas it is a source of acquiring of their revenues (Eugene fama, 1980). Some authors (S.Baiman, 1982) confirm this meaning, whereas they decide that the establishment of the interests should not be viewed as an independent entity, but as a set of relations between the agents (auditor) and principal (client) in it, whereas each of them was pushed to achieve his personal interest, hence it is important to make balance between those contradicting interests.

### **4.3. Discussion for Hypothesis 3:**

If it is being seen from the value of regression coefficient in Table 10 for variable Conflict between Auditor and Client (X3) which is negative, it means that the higher Conflict between Auditor and Client (X3) will result in the lower Auditor Independence (Y) or the lower Strengths Sources of Client (X1) will result in the higher Auditor Independence (Y). It means that it is already in accordance with results of the previous research conducted by (Kenny and Ian, 2008) who investigated that the influence of non-audit fees and client pressure on external audit evidence gathering choices and when significant non-audit services are provided, client pressure increases the extent of internal audit reliance significantly. When this finding is related to agency theory there is an in line correlation as (aWoel James card, 1981) tried to launch general assumptions concerning the behavior of the principal (client) and agent (auditor) such as:

I. Both the principal and agent are risk neutral or risk adverse.

II. The agent wishes to minimize his effort and increase his revenues.

III. The behaviors of both of the agent and principal are wise and keen.

Overall it can be concluded that conflict between them doesn't result in something good. The independent of auditor will be lower because the principal and agent are risk neutral or risk adverse, and the behavior of both of the agent and principal are always wise and keen to each other.

### **5. Conclusion:**

Based on this study, it can be concluded that there are some findings as follows:

1. The result of hypothesis one's test shows significant influence for Strengths Sources of Client (X1) to Auditor Independence (Y), the null hypothesis is ruled out, and the alternative hypothesis is valid. Therefore first hypothesis is supported, "The Pressures of the client of the institution, negatively affects the independence of the external auditor."

2. The result of hypothesis two's test shows significant influence for Sources Power of Auditor (X2) to Auditor Independence (Y), the null hypothesis is ruled out, and the alternative hypothesis is also valid. Therefore second hypothesis also is also supported, "The sources power of the auditor, positively affects of the auditor independence."

3. The result of hypothesis three's test shows significant influence for Conflict between Auditor and Client (X3) to Auditor Independence (Y), the null hypothesis is ruled out, and the alternative hypothesis is also

valid. Therefore third hypothesis also is supported, “The conflict between the auditor and client, negatively affects the independence of the Auditor.

**6. The Implication of this study:**

Based on the research, some findings could give some implications to management as follows:

1. As average value of Independence of Auditors perceived by respondent is at medium level, the Independence of Auditors has to be increased so that they could work more objectively in conducting audit work.
2. As average value of Strengths Sources of Clients perceived by respondent is also at medium level, the Strengths Sources of Clients had to be maintained or lowered so that the clients are not too much interfere auditor in conducting audit work.
3. As the average value of Sources Power of Auditor perceived by respondent is quite high, Sources Power of Auditor (X2) have to be maintained so that they could work more objectively in conducting audit work and be more independent.
4. As the average value of Conflict between Auditor and Client perceived by respondent is also at medium level so that it has to be lowered for the audit work could produce objective result without any manipulation because auditor has independency to work his task and the

audited company doesn't interfere the auditor in audit work in the company.

5. From all results of hypothesis test which all hypotheses are supported it gives implication that every parties—audit firms, companies client, share holder or event all stake holder must be aware that all variables (Strengths Sources of Clients, Sources Power of Auditor, Conflict Between Auditor and Client, and Independence of Auditors) must be really considered so that audit work will produce effective and objective results for every party needed the audit result.

### **7. Limitations of the Study:**

Certain limitations appear as follows:

1. This study is conducted only in Libya,(Musrata, Zletain, Al-khoms, and Tripoli).
2. The results of the research may not be applicable to other countries. The cultural and contextual differences may cause differences in the results. There will be a need to replicate the study in other national context.
3. Researchers studied only three independent variables, future research could determine more independent variables.
4. This study used a survey questionnaire to gather information. Alternative approaches such as an interview survey can also be used.

### **7. Suggestion for Future Research:**

Recommendations for future research might take place as follows:

1. Future research that replicates this study may be conducted in two or three countries (cross-national research) for comparison so that the result may be applicable for among the countries researched and could find deeper reason behind different results from each country which may exist.
2. Future research could determine more independent variables such as quality control of audit work, auditor's fee, and other behavioral factors such as commitment and so on.

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