

Auditor Independence and Threats: Mediating Role of Auditor Ethics

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Abstract

Introduction/Main Objectives: This research aims to examine the mediating role of auditor ethics on the influence of independent auditors on auditor threats. **Research Background:** Behind the increasing public trust in accountants recently, Independence has come under sharp scrutiny from the public. **Method:** Research was conducted using a quantitative approach. The survey participants are auditors in Indonesia. The number of respondents was 96 auditors. **Results:** The results of this study indicate that auditor ethics mediates the influence of Independence on the threats that auditors will face. Apart from that, the results of this research also show that auditor independence has a positive relationship with auditor ethics. Then, auditor ethics have a positive effect on auditor threats. **Conclusion:** This research provides implications for Auditors at the Indonesian Institute of Public Accountants to increase awareness of threats that arise through their involvement as external auditors. Awareness of the importance of professional ethics to maintain Independence from threats. This research fills the gap in the literature regarding auditor independence and threats by showing that ethics plays a mediating role in avoiding threats that auditors face. This research can enrich the literature on external audit standards, especially the auditor's duties, by prioritizing ethics in attitudes and behavior as an independent and professional auditor.

Keywords: Auditor ethics; Auditor threat; Independence.

JEL Classification: M40; M41

Article History: Received: November, 23rd 2024 Revised: April, 11th 2025 Accepted: July, 26th 2025 Published: October, 01st 2025

How to cite: Hamid et al. (2025). Auditor Independence and Threats: Mediating Role of Auditor Ethics. *AKRUAL: Jurnal Akuntansi*, 17(1). DOI: 10.26740/jaj.v17n1.p.216-227

Conflict of Interest Statement: here is no conflict of interest in the articles resulting from this research

INTRODUCTION

Behind the increasing public trust in accountants recently, Independence has come under sharp scrutiny from the public. This happened in a case that emerged in the mass media, which received much attention, namely the case of sanctions against MP Sibarani and indications of collusion with issuers about the capital market. By understanding the causes of these deviations, it is hoped that the public can put the problem in its actual proportions so as not to make inaccurate generalizations that assume all accountants are not independent. (Ogbodo & Ajuonu, 2021).

Therefore, the issue of accountant independence is interesting to study further to understand why professional deviation occurs. External auditors face many threats that can affect their Independence. If its Independence is concerned, it becomes unable to issue a fair report indicating the extent of fairness of the audited financial statements by the requirements of the relevant international audit standards (Mousa Abdel Latif Al Nawaiseh & Alnawaiseh, 2015).

Ethical Values are built on good work practices and what is right. It provides general guidelines about good behavior or the behavior of individuals, groups, and organizations.

Ethics also determines what is right and wrong and chooses what is right. Ethical values are beliefs or standards that compel us to act or choose in one way over another (Singh & Singh, 2012); (Kumar, 2014). (Lindgren, et al., 2011) As quoted (Schweitzer and Campion 1987, 57), ethics is defined as a human activity to secure the inner perfection of one's personality.

This research examines the mediating influence of auditor ethics on the relationship between auditor independence and the threats they will face. This research has several motivations. First, this research explores awareness of threats to the auditor profession. This argument is based on previous studies only examining the relationship between reputation checks on auditor independence and ethics (Irani et al., 2015) ; (Francis et al., 2017) and (Donelson et al., 2019). Second, this research wants to explore aspects of auditor ethics as a mediating variable in the relationship between independence and auditor threats. The auditor's ethical considerations relate to the ethical principles of Independence in the professional accountant's code of ethics. In the professional accounting code of ethics, clients can pressure auditors .

Threats to auditors can be reduced if Independence is high and auditors have strong ethics, 2021 Public Accountant Professional Code of Ethics, explanation regarding "acting in the public interest" A1, 100.6 – A2, 100.6 - (100.6 A3, dan 100.6 - A4). For example, when auditors carry out audits of government funds, such as campaign funds and development projects, there are often threats against the auditor, which interfere with the auditor's Independence and impact the quality of the audit or audit opinion. There are two types of Independence, first in terms of thinking, namely a mental attitude that allows a person to state a conclusion without being influenced by pressure that could compromise professional judgment, thus allowing the individual to act with integrity and apply objectivity. Second, from an appearance perspective, namely the avoidance of facts and circumstances so significant that a reasonable and knowledgeable third party would likely conclude that the integrity, objectivity, or professional skepticism of the firm or a member of the audit team has been compromised.

Existing literature suggests that non-audit services create economic ties between auditors and clients, making auditors more likely to form an unqualified opinion on a client's problematic financial statements. (Simunic, 1984 (Simunic, 1984); (Wines, 1994); (Sharma & Sidhu, 2001) and (Ettredge et al., 2017) . To the extent that non-audit services impair auditor independence, investigations into stable or unstable economic conditions influence the relationship between auditor independence and the cost of non-audit services. Previous literature shows that under unstable economic conditions, auditors are more independent (Antle et al., 1997) ; (DeFond et al., 2002) and (Carson et al., 2019), likely due to higher litigation costs. In Australia, (Carson et al., 2019) found that the Australian Securities and Investments Commission (ASIC) also increased audit scrutiny during unstable economic conditions, which in turn caused auditors to be more conservative for a given client's risk level. Thus, it is vital to understand the relationship between non-audit services provided by auditors and auditor independence during stable and unstable economic environments in Australia.

This research has several theoretical and practical contributions. The academic contribution of this research consists of first, a contribution to support the attribution theory of determination to increase auditors' awareness of emerging threats; second, a contribution to show that professional ethics mediates the relationship between auditor independence and threats; and third, a contribution to government auditors. And private auditors to increase Independence through a commitment to awareness of upholding ethical values.

This article consists of four parts: the first part is an explanation of the background of this research, the second part is an explanation of the literature review and hypothesis, the third part is an explanation of the research methodology, and the last part is an explanation of the research methodology. Explanation of research results and conclusions.

Researchers' interest in ethical studies increased after the world witnessed the collapse of large companies, this was caused by the lack of ethical display carried out by some of the company's employees. (Tang & Sutarso, 2013). The findings from this research show that people commit fraudulent acts because they do not have ethical values or do not respect their workplace's code of ethics. However, individuals with strong ethical beliefs rarely commit fraud (Mintz, 2006); (Awang & Ismail, 2018) dan (Said et al., 2018). Therefore, this study hypothesizes that:

H1. There is a positive relationship between auditor independence and ethics

(Otalor & Eiya, 2013) calls ethics a system or code based on moral obligations, duties and values that indicate how we should behave in an established society or body. Ethical behavior is behavior in any body that is considered fair, just and goes beyond the laws and constitutional regulations related to (Otalor & Eiya, 2013). The main constituent parts of accounting ethics include Independence, integrity, objectivity, confidentiality, professionalism, competence and prudence. Whenever auditors find it difficult to comply with these responsibilities, this represents a lack of integrity and consequently affects the credibility of the accounting profession. Therefore, this study hypothesizes that:

H2. There is a positive relationship between ethics and threats.

Auditor independence also affects the application of auditing standards, quality control, management pressure, and the provision of non-audit services (Beattie & Fearnley, 2002); (Kubr, 2002) dan (Abdullah Al Momani & Ibrahim Obeidat, 2013). Auditor independence increases with specialization, experience, efficiency of internal audit (Abdel-Meguid et al., 2013) and (Musa Abdel Latif Al Nawaiseh & Alnawaiseh, 2015).

Independence of mind means that the auditor must express an opinion on the financial statements without being influenced by threats from any source, and Independence of appearance means the auditor's ability to avoid circumstances or facts that, if known by third parties, would change their opinion. in the auditor's integrity, objectivity and impartiality (Ye et al., 2011). Therefore, this study hypothesizes that:

H3 : There is a positive relationship between auditor independence and threats.

H4 : Independence has an indirect positive effect on threats to auditors through auditor ethics.

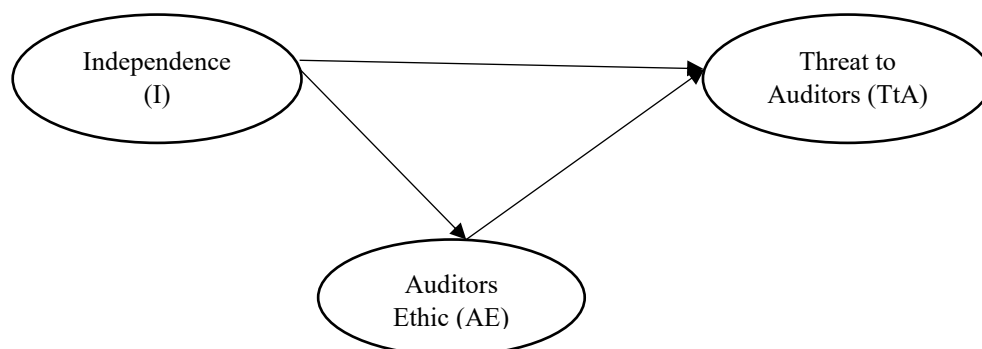


Figure 1. Conceptual Framework of Mediation

RESEARCH METHOD

This research uses a quantitative approach with survey methods. The data examined in this research comes from primary data collected from questionnaires distributed at the Indonesian Institute of Public Accountants (IAPI) which contains 252 members of public accountants in 2022 in the East Java, Bali, NTT and NTB regions. Of the population who were willing to provide their opinions as respondents, 96 respondents collected data that could be processed.

Table 1. Correspondent Characteristics

Variable	Description	Frequency	Percentage (%)
Gender	Male	35	36,5%
	Female	61	63,5%
	Total	96	100%
Age	20 - 30 years	65	67,7%
	31 – 40 years	15	15,6%
	41 – 50 years	10	10,4%
	>50 years	6	6,3%
	Total	96	100%
Education background	Diploma	32	33,3%
	Bachelor	47	49,0%
	Postgraduate	17	17,7%
	Total	96	100%
Position	Young Auditors	62	64,6%
	Senior Auditors (Supervisors)	21	21,9%
	KAP Partners and Leaders	13	13,5%
	Total	96	100%
Years' service	1 - 5 years	62	64,6%
	6 - 10 years	22	22,9%
	> 10 years	12	12,5%
	Total	96	100%

Source: data processed

Independence (of mind and appearance) means that auditors must make disclosures with honesty, loyalty, and impartiality (Abdullah, 2004) in planning, testing data, producing results, and compiling reports (Arens et al., 2008). The Independence and neutrality of the auditor are important factors that affect the credibility of financial reports (Abu Shook, 2010; Abu Ganem, 2003). Auditor independence also affects the application of auditing standards, quality control, management pressure, and the provision of non-audit services (Adam, 2014; Al Momani, 2004; Eldalahmeh, 2006; Al Kasharmh, 2003; Hamid & Al Angari, 2006)., 2007; Kubr, 2002; dan Beattie & Fearnley, 2002). The auditor's independence increases with his specialization, experience, and internal audit efficiency (Ahmmad, 2003; Kock et al., 2011). Independence means that the auditor must express his opinion on the financial statements without being influenced by threats from any source.

Ethics is a human activity directed at the perfection of the inner perfection of one's personality. Ethical values are the discipline of a man determined to do what is good and bad and with moral duties and obligations. Ethical Values are built on good work practices and what is right. It provides general guidelines about good behavior or the behavior of individuals, groups, and organizations. Ethics also determines what is right and wrong and chooses what is

right. Ethical values are beliefs or standards that compel us to act or choose in one way over another (Singh & Singh, 2012); (Kumar, 2014). (Lindgren, et al., 2011).

Threats that affect auditor independence can be classified into:

1. **Personal Interest Threats.** This threat occurs when the auditor has a material or non-material interest in the client. These threats have an impact on auditor independence. They include the benefit of his family with a client, dependence on fees from only one client, anxiety about losing a client, lending a loan or receiving a loan from a client, and conditional fees (Al Makademh, 2006; ICAIW & Kaplan, 2004). Auditors must balance benefits and threats when providing non-audit services to clients (Schmidt, 2012). Volume fees are the biggest threat to auditor independence.
2. **Threat of Self-Review.** These threats arise when the auditor receives audit tasks that he or she concludes in previous accomplishments and opinions issued to them. This also includes whether the auditor or his assistant is employed by the client company, and in a position that helps to significantly influence the audit process, or that he or his assistant prepares basic data used in the preparation of financial reports or in the audit function.
3. **Advocacy Threats.** This threat arises when the auditor supports the client in carrying out and minimizing, or promotes its shares or defends it in court cases, or intervenes to support the client's position in dealing with others.
4. **Threat to Familiarity or Intimacy.** An auditor can work with a client for a long time, which helps increase the auditor's knowledge about the client's activities. However, this can strengthen the relationship between them, nepotism, favoritism, and competition between audit firms (Sufyan & Bishtawi, 2003). Length of service affects auditor independence and changes will increase costs and reduce auditor experience (Tlitus et al., 2014).
5. **Intimidation Threats.** Clients can threaten auditors with canceling the contract between them to reduce their costs; this can reduce the auditor's objectivity (Nasution, 2013). To reduce these threats, the audit committee should: appoint auditors and determine their fees (Eden et al., 2003; and Kahle et al., 2003). By referring to several reviews of previous research, this research argues that the relationship between Independence, Auditor Ethics, and Threat is a mediating relationship. The use of Independence has a positive effect on auditor Ethics and only then does Ethics have a positive effect on auditor Threats.

RESULT & DISCUSSION

If the indicator load factor exceeds 0.6 then the indicator will be validated (Hair, 1998) to the variable in question. The output of the SmartPLS3 loading factors is as follows:

Table 2. External Loading Values

Indicators	AE	I	Itu
AE1	0.900		
AE2	0,858		
AE3	0,752		
AE4	0,890		
AE5	0,887		
I1		0,783	
I2		0,817	
I3		0,831	
I4		0,837	
I5		0,832	
TtA1			0,761

Indicators	AE	I	Itu
TtA2			0,812
TtA3			0,871
TtA4			0,791
TtA5			0,829

Source: data processed

Validation of the reflex index uses the correlation between object scores and variable scores. Measurements using reflective indicators show that the indicators of a variable have changed and other characteristics of the same variable have changed (or been removed from the version). For this observation the reflection index is used because it supports tilt detection. The table above shows that the load factor exceeds the recommended value of 0.6. The minimum value of the AE3 index is 0.752. This means that the metrics used here are valid or have achieved a convergence effect. Below is a load factor diagram for each metric in this study.

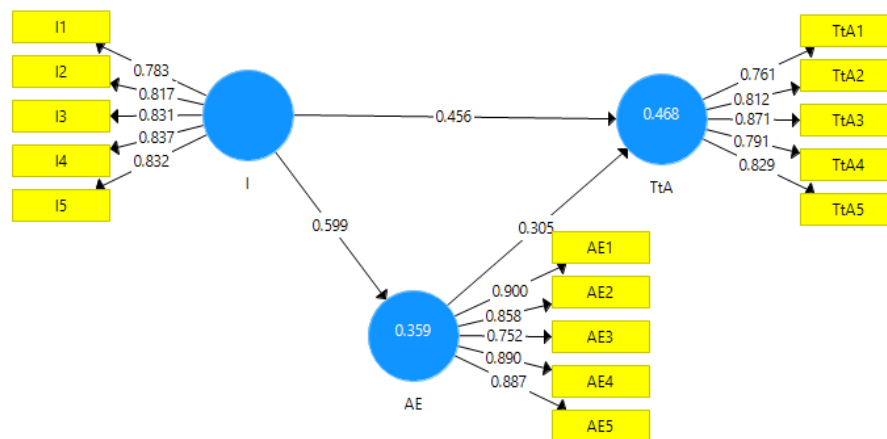


Figure 2. Loading Factor Value

Reflective indicators should also be tested for their effectiveness in cross-load discrimination.

Table 3. Cross Loading Values

Indicator	AE	I	Itu
AE1	0.900	0,507	0,492
AE2	0,858	0,604	0,458
AE3	0,752	0,520	0,553
AE4	0,890	0,472	0,456
AE5	0,887	0,449	0,511
I1	0,519	0,783	0,603
I2	0,444	0,817	0,488
I3	0,431	0,831	0,469
I4	0,534	0,837	0,455
I5	0,513	0,832	0,577
TtA1	0,531	0,555	0,761
TtA2	0,452	0,512	0,812
TtA3	0,523	0,589	0,871
TtA4	0,407	0,471	0,791
TtA5	0,413	0,444	0,829

Source: data processed

The metric is validated when the target variable has the highest loading factor compared to other variables. In the table above, the AE indicator factor load (AE1 to AE5) is higher on the AE variable compared to other variables. The load factor of AE1 is 0.900. This is higher than load factor I (0.507) and TtA (0.492). This also applies to other variable indicators. For this reason. Potential contracts predict one block's indicators better than other blocks' indicators. Another way to verify identity is to check the AVE value. The recommended value is 0.6 or higher (Hair. 1998) . Below is the AVE value.

Table 4. AVE Value

Variable	Average Variance Extracted (AVE)
AE	0,738
I	0,673
TtA	0,662

Source: data processed

The table above shows that all variables in the research model have an AVE value greater than 0.5. The minimum AVE value for the TtA variable (Threats Against Auditors) is 0.662.

To determine reliability testing on PLS, you can use the combined reliability approach and Cronbach's alpha (Anuraga et al.. 2017) . The combined reliability results showed a satisfactory value of 0.7 or higher. This is the combined confidence value of the output.

Table 5. Composite Reliability

Variable	Composite Reliability
AE	0,933
I	0,911
TtA	0,907

Source: data processed

The table above shows that the combined reliability of all variables is greater than 0.7. Shows that each predicted variable version meets the discriminant validity criteria. The smallest combined confidence value in the TtA variable (Threats Against Auditors) is 0.907. To see the reliability of the test you can also use the Cronbach's Alpha value.

Table 6. Cronbach's Alpha

Variable	Cronbach's Alpha
AE	0,910
I	0,879
TtA	0,872

Source: data processed

The recommended value is greater than 0.6. The table above shows the Cronbach's alpha value is greater than 0.6 for all variables. The minimum value for the TtA variable (Threats Against Auditors) is 0.872.

Once the predicted version meets the requirements of the outer version. the next step is to check the structural version (deep version). The R-Square value for the variable is:

Table 7. R-Square

Variable	R- Square
AE	0,353
TtA	0,456

Source: data processed

The table above shows a value of 0.353 for the AE (Auditor Ethics) variable. This means that variable I (Independence) is able to explain 35.3% of the AE variable. The R squared value is also found in the TtA variable and is influenced by I and AE of 0.456. Analysis of the relationship between variables provides results as shown in the table below:

Table 8. Results of the relationship between variables

Correlation	Original Sample (O)	T statistics	P Value
AE -> TtA	0,305	3.293	0,001
I -> EA	0,599	5.396	0,000
I -> TtA	0,456	4.594	0,000
I -> AE -> TtA	0,183	2.417	0,016

Source: data processed

Auditor ethics refers to a set of moral principles and values that guide the behavior of auditors in carrying out their duties. On the other hand, threats to auditors refer to various factors or situations that can compromise the Independence, objectivity, integrity and quality of the auditor's work. The relationship between auditor ethics and threats to auditors is very important, because strong auditor ethics can help overcome or reduce the impact of various types of threats that auditors may face.

One of the main principles in auditor ethics is Independence, which requires auditors to maintain a distance from influences that could affect their objective judgment. Threats to Independence can come from various sources, such as financial relationships with clients or pressure from management. By adhering to ethical principles that emphasize Independence, auditors are more likely to recognize and avoid situations that could threaten their Independence. Auditor ethics also emphasizes the importance of integrity, namely the ability to act honestly and clearly in all aspects of work. Threats to auditor integrity may appear in the form of requests for bribes or encouragement to change audit reports. By upholding integrity, auditors have a strong moral foundation to resist inappropriate pressure and maintain the integrity of their work.

Auditor ethics requires auditors to maintain an objective and impartial attitude. Threats to objectivity may arise from pressure from the client to present information in a particular manner that may be inconsistent with the audit findings. By adhering to the principle of objectivity, auditors can overcome these threats and maintain accuracy and fairness in their assessments.

Auditor ethics also includes the responsibility to maintain and improve professional competence. Threats to competency may arise from demands to complete tasks quickly without adequate or lack of understanding of the area being audited. By focusing on competency, auditors can reduce the risk of threats arising from limited knowledge or skills.

Auditor ethics encourages auditors to identify and manage conflicts of interest that may affect their integrity and Independence. Threats to auditors may arise if they have relationships or personal interests that could influence their judgment. By transparently managing conflicts of interest, auditors can minimize the risk of these threats.

Overall, auditor ethics serves as a moral guide that helps auditors recognize, prevent, and overcome various threats that may affect the quality of their work. By adhering to the principles of auditor ethics, auditors can maintain professionalism and integrity in carrying out their duties, while protecting the public interest and the integrity of financial markets.

Independence is one of the main principles in auditor ethics which has a very significant influence on the integrity and quality of the auditor's work. Independence is the basis for the integrity and objectivity of an auditor. Without strong Independence, it is difficult for an auditor to maintain integrity in the face of pressure or influence that could affect audit results. Independence allows auditors to remain focused on existing facts and evidence, without being colored by inappropriate considerations.

Strictly maintained Independence helps build and maintain public confidence in audited financial reports. This trust is very important in ensuring transparency and accountability in an entity's financial reporting. When Independence is questioned, public trust can be eroded, potentially causing doubt and uncertainty in the marketplace.

Independence also functions as a barrier against possible conflicts of interest between the auditor and the client. Conflicts of interest may arise if auditors have financial or personal relationships that could influence their objective judgment. By maintaining Independence, auditors can avoid situations where conflicts of interest might undermine their integrity and professionalism.

Independence is a reflection of an auditor's professional integrity. Through consistent Independence, an auditor shows his commitment to high ethical standards and work quality. This reflects professionalism and responsibility towards the community and other stakeholders.

Independence creates the basis for the auditor's responsibility towards the public interest. Auditors have a responsibility to present accurate and reliable financial information to stakeholders. By maintaining Independence, auditors prioritize the public interest over the interests of individuals or other parties.

Strong Independence can help prevent collusion between auditors and the management of the company being audited, as well as prevent attempts to manipulate financial reports. With steadfast Independence, auditors are more likely to identify and report potential discrepancies or violations.

Overall, Independence is the pillar of auditor ethics. Loss of Independence can threaten audit quality, causing detrimental consequences for companies, investors, and society as a whole. Therefore, maintaining strong Independence is an important commitment in upholding auditor ethics and ensuring that audited financial reports reflect true reality.

The Relationship between Independence and Threats to Auditors There is a close relationship between Independence and threats to auditors in the context of financial audits. Independence is one of the main pillars in maintaining audit quality and the integrity of the auditor profession, while threats to auditors are situations or factors that can disrupt Independence and reduce the effectiveness of the auditor's work.

Threats to Independence can come from various sources, such as financial relationships with clients, giving gifts or rewards, pressure from management, or the desire to maintain good business relationships. These threats can damage an auditor's Independence and cause a decrease in objectivity in carrying out audit duties.

Weak Independence can result in a decrease in auditor objectivity in assessing client financial information. When auditors are not independent, they can be influenced by the desire to meet client expectations or avoid conflict, which in turn can affect the accuracy and reliability of the audit report.

Threats to Independence can damage the quality of the auditor's work. Auditors who are not independent may not have the incentive to dig deeper or perform a thorough audit, as they may be more inclined to rely uncritically on information provided by client management.

Threats to Independence may also cause auditors to avoid confrontation with client management when differences of opinion or problems arise during the audit. This can reduce openness in dealing with potential violations or fraud.

If Independence is compromised, public confidence in audit reports and auditor professionalism can be eroded. This can harm the image and integrity of the auditor profession and have a negative impact on the confidence of investors and other stakeholders in the audited financial information.

Threats to Independence can increase the risk of conflicts of interest. Auditors who are not independent may be more susceptible to influence from parties who have an interest in the audit results, such as management, the board of directors, or large shareholders.

Therefore, Independence is the main defense against various threats that can damage audit quality, objectivity and integrity. Auditor ethics emphasizes the importance of Independence to ensure that auditors can carry out their duties with objectivity, transparency and accountability. Efforts to address and manage threats to Independence are critical steps in maintaining public trust and integrity in the audit profession.

There is a complex relationship between Independence, threats to auditors, and auditor ethics in the context of financial audits. Independence is a central element in auditor ethics and plays an important role in preventing and reducing threats that could affect the integrity and quality of the auditor's work. Independence is one of the basic principles in auditor ethics. Auditor ethics is a set of moral rules and behavioral principles that regulate how an auditor should behave and carry out audit duties. Independence is the foundation upon which integrity, objectivity and commitment to these ethical standards are based. Threats to Independence can arise from various sources, such as financial relationships with clients, pressure from management, or conflicts of interest. These threats can undermine auditor independence and lead to a reduction in objectivity and the quality of audit work. Auditor ethics provides guidelines on how an auditor should respond and deal with various threats to his Independence. Ethical principles direct auditors to identify, prevent, avoid, or resolve situations that could compromise their Independence. Auditor ethics provide a framework for taking appropriate action to maintain Independence. Auditor ethics encourages auditors to maintain their integrity and responsibility for the work they do. In the context of Independence, integrity is about carrying out audit duties honestly and fairly without any external influence influencing the audit results. Responsibility for work involves awareness of the importance of Independence in providing accurate and reliable information. Auditor ethics also provides guidance on how to manage conflicts of interest that could threaten Independence. This involves transparency in identifying potential conflicts and taking necessary actions to eliminate or reduce them. Auditor ethics guides auditors to prioritize Independence over personal interests or other parties. Within this overall dynamic, auditor ethics provides a framework that helps auditors recognize, prevent and address threats that could compromise Independence. By adhering to ethical principles, auditors can build and maintain strong Independence, which in turn protects the quality of audit work, public trust, and the integrity of the auditor profession.

CONCLUSION

The results of this research prove that auditor ethics mediates the relationship between auditor independence and the threat that the auditor will face. The results of this research also show

that auditor independence has a positive relationship with auditor ethics. Then auditor ethics have a positive effect on auditor threats. The results of this research imply that auditors can increase awareness of threats that arise through their involvement as external auditors. Awareness of the importance of professional ethics to maintain Independence from threats. The results of this research contribute that Independence can reduce auditor threats by showing that ethical strength plays a role in avoiding threats that auditors will face. This research can enrich the literature on external audit standards, especially the auditor's duties by always prioritizing ethics in behaving and behaving as an independent and professional auditor.

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