Impact of Audit Evidence on Auditor'S Report

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Abstract

This study seeks to emphasize the importance of audit evidences, their quality characteristics and the professional judgment used to measure and to evaluate them in order to express their final audit opinion. There is no mathematical formula, neither a specific model in order to evaluate the quality of audit evidences. Their quality depends upon the professional judgment concerning the audit technical standards, the accounting references and nevertheless upon the auditor's ethics. This is one of the reasons for which the financial audit is one of the edges of economical research, highlighting the credibility of financial statements. This study employ primary and secondary source of data. Questionnaires were administered to obtain information about audit evidence and auditor report was obtained through the secondary source. The empirical findings from the binary logistic regression result revealed that sufficiency of audit evidence had a negative but insignificant and reliability of audit evidence had a positive coefficient sign but insignificant. The low value of the Mcfadden R-squared indicated that the null hypotheses were rejected and acceptance of the alternative hypotheses. The study suggested that further empirical work should be conducted in this area.
Keywords: Auditor report, Audit evidence, Audit opinion and Auditing standard.

1.1 INTRODUCTION

Auditing is a systematic process of objectively obtaining and evaluating evidence regarding assertions about economic actions and events to ascertain the degree of correspondence between those assertions and established criteria and communicating the results to interested users (American Accounting Association, 1972). In order to give an assurance about the financial statements of an entity, the auditor receives assertions from the management about these reports. These assertions cannot be trusted and the auditor needs to collect evidence that confirms that the information produced by the management is accurate. Audit evidence includes written and electronic information that permits the auditor to reach conclusions through reasoning. In this respect, audit evidence help auditors to establish a starting point from which an auditor expresses audit opinion on the accounts and financial operations of the company being audited. Such evidence is obtained from tests that determine how well accounting controls work and from tests of accounting details (such as completeness and disclosure of information).

Auditors, by doing audits in accordance with the generally accepted auditing standards (GAAS), will attest to the fairness of corporate financial reports by detecting and reporting material deviations from the generally accepted accounting standards to various stakeholders (lin, Liu, & Wang, 2009). Hence, independent audit can decrease the asymmetry information and agency problem. Audit opinion about accounting information by the decrease of agency problem can provide the usefulness of accounting information to the capital market participants. The usefulness of accounting information can effect on the decision making of users. So, in order to increase the usefulness of accounting information, auditors add the assurance of financial information which it can results to increase the value relevance. Hence, when audit report has value relevance, it can improve decisions of users about rational investment, credit, and etc. Thus, it expected that audit report (i.e. unqualified audit report or other audit report) can effect on positively the value relevance and a positive signal send to capital market.

1.2 PROBLEM STATEMENT

Recent financial statement manipulations such as by Enron, Worldcom, or Parmalat revealed that information provided by financial statements does not always correspond with reality. At least in the most recent case of Parmalat, as well as in the cases of Comroad and FlowTex in Germany, management counterfeited documents and receipts for non-existent assets or transactions. These scandals illustrated clearly that it is not sufficient to rely on documents, receipts, or management representations to be what they seem at first glance. Rather, the auditor must go beyond the façade and question the truth of any information received. Responding to these developments, standard setters have tightened professional auditing standards. Their reaction was to strengthen the requirement of professional skepticism, of a critical evaluation of audit evidence, and of explicitly considering the possibility of fraud (AU 316, 2005). Independent of possible manipulations, auditors are required to judge whether financial statements provide a true and fair view of the audited entity's financial position, results of operations, and cash flows (ISA 200.2 & 14, 2005).

Independent audits enhance the credibility of corporate financial reports and assist investors to make rational decisions in the capital market. The users are perceived to gain benefits from the increased credibility. These benefits are typically considered to be that the quality of investment decisions are improved when they are

based on reliable information. Therefore, this study attempt to find answers to the following research questions:

   (i)   To what extent does sufficient audit evidence affect audit report?

   (ii) Is there any relationship between reliability of audit evidence and audit report?

1.3 OBJECTIVES OF THE STUDY

The broad objective of this study is to provide empirical evidence on the impact of audit evidence on audit report. The specific objectives will include:

   (i)   To evaluate the impact of sufficient audit evidence on audit report.

   (ii) To investigate the influence of reliability of audit evidence on audit report.

1.4 HYPOTHESES DEVELOPMENT

The following hypotheses are formulated to be tested

HO: Sufficient audit evidence has no significant impact on audit report.

HO: Reliability of audit evidence has no significant impact on audit report.

LITERATURE REVIEW

2.1 AUDITORS REPORT

Audit report is a means by which the auditors express their opinion on the truth and fairness of a company's financial statements for the benefit of principally of the shareholders, but also for other users (Adeniyi, 2004). Auditors' report on financial statements should contain a clear expression of opinion, based on review and assessment of the conclusion drawn from evidence obtained in the course of the audit.

The various changes in accounting, financial reporting and auditing were all designed to provide protection to investors. This is being achieved by imposing a duty of accountability upon the managers of a company (Crowther & Jatana, 2005). In essence, auditing is used to provide the needed assurance for investors when relying on audited financial statements. More precisely, the role of auditing is to reduce information asymmetry on accounting numbers, and to minimize the residual loss resulting from managers' opportunism in financial reporting. Audit evidence needs to support the auditors opinion in the auditor's report and the audit file should indicate how the auditor has arrived at their audit opinion.

2.2 SUFFICIENT AUDIT EVIDENCE AND AUDIT REPORT

Audit evidence is the information obtained by the auditor in arriving at the conclusions on which the audit opinion is based (Adeniyi, 2004). Audit evidence will comprise of source documents and accounting records underlying the financial statements and corroborating information from other sources. However, the auditor should obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the audit opinion in order to arrive at quality audit reporting. Audit evidence is usually persuasive rather conclusive, so different sources are examined by the auditors (Adeniyi, 2004).

According to the ISA, audit evidence need to be 'sufficient' and 'appropriate'. Sufficient refers to the quantity, as well as the quality, of the audit evidence. Appropriateness of audit evidence is related to the nature and timing of audit procedures. Appropriateness (the quality of evidence) is achieved if the evidence obtained is relevant and reliable. Also, the audit evidence should be sufficiently documented so that they can be used before issuing the auditor's report.

Audit evidence needs to support the auditors opinion in the auditor's report and the audit file should indicate how the auditor has arrived at their audit opinion. Regarding this aspect, in the past audit firms (like Arthur Andersen in Enron scandal) have been accused by public opinion and regulatory bodies because the audit evidence that they have obtained has not been sufficient or appropriate enough to justify their audit opinion. Auditors must ensure that when planning and performing audit procedures, they believes that these procedures are adequate enough in order to obtain sufficient and appropriate audit evidence (because audit procedure and audit evidence are not the same – auditors use procedures to generate evidence). Other aspects that auditors need to consider are relevance and reliability of the information to be used as audit evidence (Collin Steve, ISA 500).

2.3 RELIABILITY OF AUDIT EVIDENCE AND AUDIT REPORT

The relevance of the audit evidence should be considered in relation to the overall audit objective of forming an opinion and reporting on the financial statement (Adeniyi,2004) It is necessary to verify non-responses with alternative reliable evidence of the outstanding balance in order to maintain the integrity of the sample where positive confirmations are used. Such evidence includes delivery notes signed for by the customer, written customer sales orders and, if subsequently paid, a remittance advice accompanying the payment identifying the specific invoices being paid (Florea, 2010). Creditors are much less frequently confirmed than debtors. The auditor already has external evidence in the form of supplier invoices and statements. Although held by the entity and thus potentially at risk from being manipulated, they are likely to provide sufficient appropriate evidence in the absence of any suspicious circumstances. In addition, the principal assertion verified by confirmation evidence would be that of completeness. The available population (creditor balances recorded

by the entity), is not a suitable starting point for selecting a sample for confirmation when verifying completeness. If time is available, auditors tend to prefer to use the complementary/reciprocal population of purchases (or payment transactions recorded after the period end) when verifying the completeness of recorded creditors. In many countries, the auditing profession has come to a mutual agreement with the banking industry on the method to be employed in seeking confirmations. A standardized form is commonly used with open questions for the bank to complete. The evidence should be reliable because banks usually maintain a high level of internal control over records of customer balances (Florea, 2010).

Understanding how persuasiveness and sequential presentation of audit evidence affect auditors' judgments is particularly important in situations where there is conflicting (positive and negative) audit evidence of varying strengths. For example, consider a situation where the auditor is presented with positive audit evidence from a source with high reliability followed by negative audit evidence from a source with low reliability. The literature suggests two different outcomes. Studies have shown both that auditors place greater weight on negative evidence compared to positive evidence (Asare, 1992; McMillan & White, 1993) and that they are sensitive to source reliability (Hirst, 1994; Goodwin & Trotman, 1996; Goodwin, 1999). Whether the direction (positive or negative) or source reliability (high or low) of the pieces of audit evidence plays important role in affecting the quality of audit report. Prior psychological literature shows that individuals place more weight on evidence from a more reliable source when presented with conflicting evidence (Rosenbaum & Levin, 1968). In auditing contexts, when presented with conflicting audit evidence, auditors are expected to place greater weight on audit evidence from a more reliable source. Also, legal and professional requirements emphasize source reliability factors. Despite auditors being concerned with financial statement errors going undetected, they are likely to pay more attention to source reliability factors when presented with conflicting evidence. This situation will occur because auditors do not face a significant increase in perceived risk of legal liability for placing lower weight on conflicting audit evidence from a less reliable source compared to conflicting audit evidence from a more reliable source.

3. METHODOLOGY

This study is an explanatory study. Saunders, Lewis and Thornhill (2003) stated that studies that establish causal relationships between variables may be termed explanatory studies. They emphasized that this has to do with studying a situation or a problem in order to explain the relationships between variables. This research strategy was considered necessary because of its ability to view comprehensively and in detail the major questions raised in the study. The study used both primary and secondary sources of data. A questionnaire was used for soliciting information about the independent variables (Audit evidence information). Closed ended questions that would be used in the questionnaires are dichotomous questions (that is questions with options to choose either 'Yes' or 'No') and Likert type questions which refer to a kind of multiple choice question that measures the intensity with which agrees to a statement made. One hundred questionnaires are administered to members of organizations who are auditors and accountants. The dependent variable is audit report. Since the dependent variable is on audit report of quoted companies in Nigeria, population of the study is made up of companies listed on the floor of the Nigerian Stock Exchange (NSE) for the period 2007 to 2011. A sample of twenty (20) audited financial reports of quoted companies for the period 2007 to 2011

Year-end was used.

MODEL SPECIFICATION

The hypotheses formulated for this study were tested with the use of logistic regression model. This was used to examine the relationship between dependent and independent variables. According to Field (2000), logistic regression is multiple regression but with an outcome variable that is a categorical dichotomy and predictor variables that are continuous or categorical. The logistic regression for this study takes the form:

$$AUDITR = \beta_0 + \beta_1 BSAUDE + \beta_2 RAUDE + \varepsilon$$

OPERATIONALIZATION OF VARIABLES

$\beta_1 - \beta_2$ = Coefficients of explanatory variables

ε = Error term over cross-section and time

Dependent variable

AUDITR = Audit report. This variable is dichotomous in nature. Audit opinion was used as proxy for audit report. '1' If Unqualified audit opinion is reported otherwise '0'.

Independent variables

SAUDE = Sufficient audit evidence

RAUDE = Reliability of audit evidence

Likert type questions which refer to a kind of multiple choice questions that measures the intensity with which agrees to a statement made. '1' for agree, '2' for undecided and '3' for disagree as a proxy for the independent variables.

4. DISCUSSION OF RESULT

The analyzed data was presented using descriptive statistics, frequency tables and a stepwise logistic regression technique. The descriptive statistics allow the generalization of the data to give an account of the structure of the population as represented by the sample.

4.1   DEMOGRAPHIC CHARATERISTICS OF RESPONDENTS

Hundred (100) questionnaires were given out to respondents but only 70 were returned and usable, and subsequently analyzed.

SEX DISTRIBUTION OF RESPONDENTS

SEX	FREQUENCY	PERCENTAGE
MALE	49	70
FEMALE	21	30
TOTAL	70	100%

The table above shows the gender categories of the 70 respondents who returned usable copies of distributed questionnaires of whom 49 (70%) were males and 21(30%) were females. This shows that majority of the respondents were males.

OCCUPATIONAL DISTRIBUTION OF RESPONDENTS

OCCUPATION	FREQUENCY	PERCENTAGE
AUDITOR	28	40
ACCOUNTANT	42	60
TOTAL	70	100%

Table above shows the occupational distribution of the valid questionnaire. From the respondents view, 28(40%) were represented by auditor and 42(60%) of them were accountant.

DISTRIBUTION OF RESPONDENTS BY MARITAL STATUS

MARITAL STATUS	FREQUENCY	PERCENTAGE
MARRIED	42	60
SINGLE	21	30
DIVORCED	7	10
TOTAL	70	100%

The above table shows the marital status of the respondents who returned valid questionnaires distributed. 21 (30%) of the respondents were single, 42 (60%) were married and 7(10%) of them were divorced.

ACADEMIC STATUS OF RESPONDENTS

ACADEMIC	FREQUENCY	PERCENTAGE
DEGREE	28	40
MASTER	35	50
DOCTORATE	7	10
TOTAL	70	100%

The table above shows the academic status of the respondents. 28(40%) of the respondents had first degree, 35(50%) of them had master degree and 7(10%) of the respondents had doctorate degree.

4.2 ANALYSIS OF REGRESSION RESULT

Table 1 Logistic Regression Model of Sufficiency and Reliability of Audit Evidence and Audit Report.

EXPANATORY VARIABLE	COEFFICIENT	Z-STATISTIC	PROB-VALUE
CONSTANT	-0.1610	-0.2005	0.8410
SAUDE	-0.6494	-1.2461	0.2127
RAUDE	0.3579	0.9978	0.3183

McFadden R^2= 0.031393

LR Statistic= 2.930573, Prob (LR Stat). = 0.231012

From table 1 above, it would be observed from the coefficient of determination (McFadden R^2) value of 0.031393 show that about 3% of the systematic variation in the dependent variable is jointly explained by the independent variables. This means that the model is not good fit since almost 97% of systematic variation in the variables over the periods is not explained. The LR statistic value of 2.930573 and its associated p- value 0.231012 show that the model on overall is not statistically significant. This means that the coefficients of the independent variables are not statistically different from zero.

Following the above, it should be noted that Sufficiency of audit evidence (SAUDE) has a negative coefficient but insignificant impact on Audit report(AUDITR) and the variable Reliability of audit evidence (RAUDE) has a positive coefficient sign but insignificant. The insignificant of the variables is that the Z-test was failed by the variables. The low value of the McFadden R^2 revealed that the null hypotheses is accepted thereby leading to the

rejection of the alternative hypotheses.

5. CONCLUSION AND RECOMMENDATION

In an audit, most work is affected by auditor to obtain and evaluate evidence, using various procedures (inspection, observation, investigation, confirmation, recalculation, re-performance, etc.) in arriving at audit opinion. Obtain audit evidence (sufficient and appropriate) is one of the most important steps that auditors should make and that is crucial in shaping the overall standard governing audit evidence. Audit evidence should be properly documented to ensure that the objective of the audit was achieved. If the objectives were not achieved, the working papers must contain documentation of failure. Also, the use of experts could be considered as audit evidence and auditors must know when their expertise is exceeded.

This study therefore suggested that further empirical work should be done this area (impact of audit evidence on audit report).

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Dependent Variable: AUDITR

Method: ML - Binary Logit (Quadratic hill climbing)

Date: 07/10/13   Time: 15:39

Sample: 1 70

Included observations: 70

Convergence achieved after 4 iterations

Covariance matrix computed using second derivatives

Variable	Coefficient	Std. Error	z-Statistic	Prob.
C	-0.161021	0.802793	-0.200576	0.8410
SAUDE	-0.649461	0.521156	-1.246193	0.2127
RAUDE	0.357911	0.358673	0.997876	0.3183
McFadden R-squared	0.031393	Mean dependent var		0.385714

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S.D. dependent var	0.490278	S.E. of regression	0.488252
Akaike info criterion	1.377434	Sum squared resid	15.97213
Schwarz criterion	1.473798	Log likelihood	-45.21018
Hannan-Quinn criter.	1.415711	Deviance	90.42036
Restr. deviance	93.35093	Restr. log likelihood	-46.67547
LR statistic	2.930573	Avg. log likelihood	-0.645860
Prob(LR statistic)	0.231012		

Obs with Dep=0	43	Total obs	70
Obs with Dep=1	27		

AUDITR	SAUDE	RAUDE
0	1	2
0	1	2
1	1	1
1	1	1
0	1	1
1	1	1
1	1	3
1	1	3
0	1	3
0	1	1
0	2	1
1	1	1
0	1	1
0	1	1
0	3	1
1	1	1
1	1	1
0	1	1
1	1	1
0	1	1
1	1	1
0	1	1
0	1	1
0	3	3
0	1	1
1	1	2
1	1	3
1	1	1
0	1	1
0	1	1
1	1	1

1	1	1
1	1	1
1	2	1
1	1	1
0	1	1
0	1	1
1	1	1
1	2	1
1	1	1
0	1	3
1	1	3
1	1	1
1	1	1
1	2	1
1	1	1
0	1	1
0	1	3
1	1	3
0	3	1
0	1	1
0	1	1
0	1	1
0	1	1
0	1	1
0	1	1
0	1	1
0	1	1
0	1	1
0	1	1
0	3	1
0	3	1
0	1	1
0	1	1
0	1	1
0	1	1
0	1	1
0	3	1

QUESTIONNAIRE

This questionnaire is designed to elicit information from respondents on the impact of audit evidence on audit report. Information obtained will be treated in strict confidence and in fact, it is an academic exercise. Accurate supply of information would be highly appreciated.

SECTION A

1. Sex: Male [ ]   Female [ ]
2. Occupation: Auditor [   ] Accountant [   ]
3. Marital Status: Married [   ] Single [   ] Divorced [   ]
4. Academic Status: Degree[   ], Master Degree [   ]Doctorate [   ]

SECTION B

Please tick as appropriate.

1. Would you agree that audit report is a written communication of the results of the audit undertaken? (a) Agree [   ] (b) Undecided [   ] (c) Disagree [   ].
2. Timely audit report adds value to the entity. (a) Agree [   ] (b) Undecided [   ] (c) Disagree [   ].
3. Is sufficiency a measure of the quality of audit evidence? (a) Yes [   ] (b) No [   ]. (c) Don't know [   ].
4. Audit evidence is necessary to support the auditor's opinion and report. (a) Yes [   ] (b) No [   ] (c) don't know [   ].
5. Do you agree that information which served as audit evidence may be prepared using work of a management expert? (a) Agree [   ] (b) Undecided [   ] (c) Disagree [   ].
6. Do you agree that external source of evidence is more reliable than that of obtained from the entity's record? (a) Agree [   ] (b) Undecided [   ] (c) Disagree [   ].
7. Audit reporting should comply with applicable laws and regulation. (a) Yes [   ] (b) No [   ] (c) don't know [   ].
8. Do you agree that sufficient audit evidence has a strong impact on audit   report? (a) Agree [   ] (b) Undecided [   ] (c) Disagree [   ].
9. Are working papers good examples of audit evidence? (a) Yes [   ] (b) No [   ] (c) I don't know [   ].
10. Audit evidence obtained from entity's record is more reliable when internal control system operates effectively. (a) Yes [   ] (b) No [   ] (c) don't know [   ].
11. The quality of audit evidence needed is affected by the auditors' assessment of risks of material misstatement. (a) Yes [   ] (b) No [   ] (c) I don't know [   ].
12. Does sufficient audit evidence obtained help to reduce audit risk? (a) Yes [   ] (b) No [   ] (c) I don't know [   ].
13. Would you agree that reliability of audit evidence influence quality audit reporting? (a) Agree [   ] (b) Undecided [   ] (c) Disagree [   ].
14. Is there any unit of measuring the amount of audit evidence? (a) Yes [   ] (b) No [   ] (c) I don't know [   ].
15. Does audit evidence useful in establishing an accurate presentation of the financial statements? (a) Yes [   ] (b) No [   ] (c) I don't know [   ].
16. Audit evidence in the form of document and written representation is more reliable than oral representation. ? (a) Yes [   ] (b) No [   ] (c) I don't know [   ].
17. Do you agree that sufficiency of audit evidence is determined by the size of the sample selected by the auditor? (a) Agree [   ] (b) Undecided [   ] (c) Disagree [   ].

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