International Journal of Sciences: Basic and Applied Research (IJSBAR)

ISSN 2307-4531
(Print & Online)

http://gssrr.org/index.php?journal=JournalOfBasicAndApplied

The Importance of Auditor's Report

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Abstract

Companies and their business operations represent an important segment of the economic system of a country and they could have a significant impact on its further economic growth. Therefore, these companies should have a stable financial structure and be a model of high-quality financial reporting, or else they could greatly impede smooth functioning of other stakeholders on the market. With respect to that, the auditor is expected to provide going concern assessment in his/ her report in order to timely alert any red flags related to this issue. The purpose of this paper is to analyse the solvency level and its impact on the type of auditor's opinion. The awareness of association between auditor switching and the audit opinion is essential when legislation regarding mandatory audit practice is being done.

Keywords: financial statements; auditor; auditor's report; auditor's opinon.

1. Introduction

Companies prepare financial statements of their activities, which represent their overall performance. These financial statements are examined and evaluated by independent persons, who assess them according to the industry's generally accepted standards. This examination and evaluation is an audit [1].

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Thus, an audit is an examination and verification of a company's financial and accounting records and supporting documents by an independent professional against established criteria. When preparing financial statements for completion, they often must contain an auditor's report from an external accountant or auditor. This document evaluates the financial statement's validity and reliablity. An auditor's report is ultimately intended to provide reasonable assurance that there are no material errors within an organization's financial statements. Changes in the expectations of society and technology, but also a series of accounting scandals in almost all sectors of the economy, have made the role of auditors more accountable. The public is expecting auditors to be the guardians of proper and continuous functioning of the entity's business or going concern assumption [2]. Therefore, an entity is considered as continuing business if it is able to carry on its operations in the foreseeable future. Auditor's contribution in that sense is to prove the credibility of financial statements, which means that they are presented truly and fairly, as well as reliable, for all stakeholders. In this manner, auditors should state in their reports if there are any intentional material misstatements that could mislead users in making proper decisions. Nevertheless, an auditor should disclose red fl ags or state if there are any indications, that could be a sign of heightened risk related to future entity's operations. Different authors stated that many entities collapsed unexpectedly, soon aft er they have published fi nancial statements showing financial issues (Margret, 2012) [3]. This could be a significant issue and concern for the managers and owners, and especially for investors who require that their investments provide adequate returns in the future. Th us, auditors should provide necessary information about the financial ability of an entity to reimburse its debts, but at the same time, be able to continue its business operations [4]. The audit methodology includes: inspection of documentation, examination of policies and procedures, standards and guidelines, processes and frameworks, interviews and inquiries with employees, as well as testing and analytical procedures.

2. Features of auditing

- Audit is a systematic and scientific examination of the books of accounts of a business;
- Audit is undertaken by an independent person or body of persons who are duly qualified for the job.
- Audit is a verification of the results shown by the profit and loss account and the state of affairs as shown by the balance sheet.
- Audit is a critical review of the system of accounting and internal control.
- Audit is done with the help of vouchers, documents, information and explanations received from the authorities. The auditor has to satisfy himself with the authenticity of the financial statements and report that they exhibit a true and fair view of the state of affairs of the concern.
- The auditor has to inspect, compare, check, review, scrutinize the vouchers supporting the transactions and examine correspondence, minute books of share holders, directors, Memorandum of Association and Articles of association etc., in order to establish correctness of the books of accounts.

The financial statement auditor will perform audit procedures to obtain sufficient, appropriate audit evidence to support his or her opinion on the financial statements. To conduct this work efficiently, various supporting documents from the company will be requested, including documentation (for example, written documentation on the basis for management's significant accounting estimates and cost allocations), reconciliations (for example, reconciliations between SAP accounts and supporting reports, modules and systems) and source data to support transactions (for example, contracts, invoices, forms, requisitions etc.) [5].

3. External auditors

External auditors are independent accounting/auditing firms that are hired by companies subject to an audit. External auditors express their own opinions on whether the financial statements of the company in question are free of material misstatements (these could be due to fraud, error or otherwise). For publicly-traded companies, external auditors could also be required to provide an opinion on the effectiveness of internal controls over financial reporting.

4. Internal auditors

Internal auditors are those who are employed by the company that they audit. They primarily provide audits related to the effectiveness of the company's internal controls over financial reporting. Since the Sarbanes Oxley Act of 2002 was placed into effect, they must also assess the effectiveness of management’s internal controls over financial reporting. Internal auditors are not independent of the company they perform audit procedures for, but they usually do not report directly to management, in order to reduce the risk that they will be swayed to produce biased assessments.

5. Preparation of the auditor's report

Before the audit, management provides financial information to the audit committee. During the annual audit, the auditor has to review the processes and procedures that the company used to prepare the financial information. The auditors check to see whether the company uses GAAP or other applicable reporting frameworks in preparing the reports [6]. Annual audits demonstrate transparency in corporate financial reporting, which is a positive step in establishing good relationships between companies and their investors, as well as the public. After auditing an organization's financial statements, the auditor will prepare their own report where they share their opinion about the validity and reliability of the financial statements. The auditor is expected to provide a true picture of the organization and their financial statements. In the report, they must also state their connection to the financial statements, as well as whether they work for the company externally or internally. The auditor can also express any reservations or additional information that they may have in the auditor's report. For example: if the auditor disagrees with the organization about the valuation of an asset, and they believe that this has a substantial impact on the financial statements, they should state this in their report.

6. Content of the audit’s report

Rules are in place which outline what information an auditor's report should include, as well as in what order their report should be presented. As with almost all accounting documents, auditor's reports are required to adhere to generally accepted standards that are established by the local governing bodies. Standards such as the Generally Accepted Accounting Principles ensure that the auditor's report on the fairness of certain financial statements is based on a generally accepted government framework.

A general auditor's report would include [7]:

- The name of the company they have audited as well as their accounting method
- A summary of the auditor's responsibility and their report
- The auditor's reservations (if any)
- Conclusion

- Additional information
- A report by the organization's management
- The date of the report and signature of the auditor

7. The importance of auditor's report

The audit report is the report that contains the audit opinion which is issued by independence auditor after their examination on the entity financial statements. In simple words, they review whether or not financial statement prepared true and fair view in accordance with the accounting standard.

The importance of the audit report has multiple meanings [8]:

- Provide assurance on financial statements. It is issued by the professional auditor.
- The report helps the users of the financial statement to assure that financial information is correct or not.
- As the auditor is independent auditor it is proof that the company is true to their shareholder or not.
- The most important thing is that the government want the business to follow the rules and regulation so audit report tells that they are following the rules and regulation.
- The report converts in easy language so that general people can understand as many shareholders want to know about the audit report.
- Audit report helps the shareholder as the shareholder can believe that company is good and there is no problem.

8. Advantages of an audit report

An audit report is an appraisal of a small business's complete financial status. Completed by an independent accounting professional, this document covers a company's assets and liabilities, and presents the auditor's educated assessment of the firm's financial position and future. Audit reports are required by law if a company is publicly traded or in an industry regulated by the Securities and Exchange Commission (SEC). Companies seeking funding, as well as those looking to improve internal controls, also find this information valuable[9]. Anyone whose business has a number of staff, functions, office locations or technical systems that s/he is not personally and solely operating may run the risk of errors or irregularities occurring in their business. It is also desirable to check and deter fraud by carrying out a regular audit.

- An audit helps to identify weaknesses in the accounting systems and enables us to suggest improvements. The process keeps our partners informed of areas/situations where advice is useful.
- An audit assures directors not involved in the accounting functions on a day-to-day basis that the business is running in accordance with the information they are receiving, and helps reduce the scope for fraud and poor accounting.
- An audit facilitates the provision of advice that can have real financial benefits for a business, including how the business is running, what margins can be expected and how these can be achieved. Advice can cover anything from the tightening of internal controls, to reducing the risk of fraud or tax planning.
- An audit will enhance the credibility and reliability of the figures being submitted to prospective purchasers. If an owner manager is planning on selling in the next 3 years, it may be beneficial to carry out regular audits.
- An audit may be advantageous if a company is growing and likely to exceed the turnover threshold in the near future, in order to avoid having to revisit the previous years' figures, once the threshold has been reached.
- An audit adds credibility to published information for employees, customers, suppliers, investors and tax authorities:Credit ratings may be affected by not having an audit. Suppliers may not be prepared to give appropriate credit limits. Banks and trade suppliers rely in part on credit rating agencies' assessment of the company, and will look more favourably on companies that have an auditThe HMRC may consider the figures to be less reliableIn the event of insurance claims, loss adjusters often have more faith in audited accounts.
- An audit provides assurance to shareholders (if they are not directors closely involved in the business) that the figures in the accounts show a true and fair view.
- Improved Management Decisions

Managers and executives rely heavily on current financials, budgets, and forecasts to make business decisions, like hiring new team members and launching new lines of business. Errors at this stage can be critical, so it's important for management to work with the most reliable information possible. Audited financial statements can provide an extra layer of confidence, allowing management to make specific changes that can promote positive corporate growth and development with the knowledge that the key numbers they are using are correct. For some businesses, especially those seeking acquisitions or planning large capital expenses, third-party loans are essential. Banks and other lenders generally limit activity to only proven companies with solid business models, restricting access to those without trustworthy reporting. An audit can provide the verifiable records banks and other lenders like to see, increasing odds of receiving a loan – and better terms and interest rates.

9. Types of auditor opinions

Auditors have the option of choosing among four different types of auditor opinion reports. An auditor opinion report is a letter that auditors attach to the statutory audit report that reflects their opinion of the audit.

The four types of auditor opinions are:

- Unqualified opinion-clean report
- Qualified opinion-qualified report
- Disclaimer of opinion-disclaimer report
- Adverse opinion-adverse audit report

An unqualified opinion is considered a clean report. This is the type of report that auditors give most often. This is also the type of report that most companies expect to receive. An unqualified opinion doesn't have any kind of adverse comments and it doesn't include any disclaimers about any clauses or the audit process. This type of report indicates that the auditors are satisfied with the company's financial reporting. The auditor believes that the company's operations are in good compliance with governance principles and applicable laws. The company, the auditors, the investors and the public perceive such a report to be free from material misstatements. When an auditor isn't confident about any specific process or transaction that prevents them from issuing an unqualified, or clean, report, the auditor may choose to issue a qualified opinion. Investors don't find qualified opinions acceptable, as they project a negative opinion about a company's financial status. Auditors write up a qualified opinion in much the same way as an unqualified opinion, with the exception that they state the reasons they're not able to present an unqualified opinion. A common for reason for auditors issuing a qualified opinion is that the company didn't present its records with GAAP. When an auditor issues a disclaimer of opinion report, it means that they are distancing themselves from providing any opinion at all related to the financial statements. Some of the reasons that auditors may issue a disclaimer of opinion are because they felt like the company limited their ability to conduct a thorough audit or they couldn't get satisfactory explanations for their questions. They may not have been able to decipher the correct nature of some transactions or to secure enough evidence to support good financial reporting. Auditors that aren't allowed an opportunity to observe operational procedures or to review particular procedures may feel like they're not able to express a definite opinion, so they feel a disclaimer is necessary and in order. The general consensus is that a disclaimer of opinion constitutes a very harsh stance. As a result, it creates an adverse image of the company. The final type of audit opinion is an adverse opinion. Auditors who aren't at all satisfied with the financial statements or who discover a high level of material misstatements or irregularities know that this creates a situation in which investors and the government will mistrust the company's financial reports. An auditor's adverse opinion is a big red flag. An adverse audit report usually indicates that financial reports contain gross misstatements and have the potential for fraud. Adverse opinions send out a high alert that the company's records haven't been prepared according to GAAP. Financial institutions and investors take this opinion seriously and will reject doing any kind of business with the company. Auditors use all types of qualified reports to alert the public as to the transparency, reliability and accountability of companies. Auditor opinions place pressure on companies to change their financial reporting processes so that they're clear and accurate.

Companies, investors and the public highly value unqualified reports.

10. Conclusion

A couple of things that make audit reports so complicated is that some of the information isn't readily available and some of the information is subjective in nature. Auditors have to make various judgmental assumptions in finalizing reports. The audit opinion is a very important part of the audit report because it makes a statement about a company's financial status to investors. The audit report provides a picture of a company's financial performance in a given fiscal year. Investors analyze audit reports and base much of their investment decisions on information contained in the audit reports. Investors are particularly interested in the audit opinion because it's a reflection of the integrity of the audit report and projects an image of the company. The audit opinion is based on such things as how available the data was to them, whether they had an opportunity to follow all due procedures, the level of materiality and other issues along those lines. All of these things are subjective in nature and depend on the auditor's opinion. An adverse audit opinion can deflate a company's status. In some cases, adverse audit opinions may lead to litigation. Regulatory bodies may also scrutinize the audit opinion and the audit report to verify the information for accuracy and any impact on taxation matters. Board management software programs support the accountability and transparency of financial reporting to ensure that companies get the best auditor opinion letter. Governance Cloud by Diligent Corporation is a fully integrated platform of board management software solutions that will ensure that companies get through the audit process with flying colors. The platform assures confidentiality with its state-of-the-art security features. Boards can set granular permissions so that only authorized parties have access to various parts of the auditing process. Auditors form their opinions by making professional judgments and getting legal opinions. It's vital that companies have internal controls and financial policies in place and have them reviewed regularly by the company's internal audit team to ensure that everything is in order before the audit ensues.

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