Audit Quality Of Financial Statements : An Exploratory Study Of Investors

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ABSTRACT

Auditing is the examination of books, accounts and vouchers of the business. The purpose is to satisfy the balance sheet shows a true and fair view of the state of affairs of the business and the profit and loss derived by the business during the financial period. Enron, Xerox, Satyam, are difficult to imagine but have happened. These failures on the part of auditors, auditing process etc to identify bad book keeping, accounting lapses, tampered evidence, booking questionable revenues etc have given the investors a “?” on the quality of audit presented to them. In the changed scenario the importance of audit quality has emerged significantly. A perusal of review of literature brings home the fact that a number of studies have been conducted abroad for understanding the audit, audit quality, perception about audit and audit quality from the perspective of common investors but limited studies have been conducted in India and most of the studies are related to perception of retail investors towards stock market so this study was undertaken among 100 investors to understand perception and attitude of retail investors and determine the measures needed to improve investors’ confidence in the audit, audit process etc. The study found that majority of the investors under study were aware about the Satyam scam, ii) auditors are more concerned in keeping the company happy and satisfied and that audit is a significant and integral part in decision making and most of the respondents consider it to be beneficial to both the company and investors. The study recommended disseminating more information in audit report, conduct of awareness campaigns, more powers to audit committee, setting up of a quality assessing and accrediting organization.

Introduction

Financial statements are the only and the most important tool before investors for measuring and judging the economic health of an organization. Financial statements of an organization shows – what the company woes and owns. Gaining and accessing the reliable, quality, true and fair financial information is helpful to investors in ascertaining their stakes in the organization and also helpful to them in picking tomorrow’s winning stocks and avoiding tomorrow’s losses. So it is important for an investor to obtain reliable, quality, true and fair financial information, one of the ways set up in order to ensure availability of reliable financial information is “Auditing”. Auditing is the examination of books, accounts and vouchers of the business. The purpose is to satisfy the balance sheet shows a true and fair view of the state of affairs of the business and the profit and loss derived by the business during the financial period. The auditor, to satisfy himself of the above facts, may obtain such information and explanation that would be necessary in the matter. Further, if he is not satisfied with the position of the business as shown in the balance sheet and profit and loss account, he must report as to why he is not satisfied.”(Spicer and Pegler). The main object of auditing is to state whether the accounts give a “true and fair view” (Section 227 of the companies Act, 1956). Enron, Xerox, Satyam, are difficult to imagine but have happened. These failures on the part of auditors, auditing process etc to identify bad book keeping, accounting lapses, tampered evidence, booking questionable revenues etc have given the investors a “?” on the quality of audit presented to them. In the changed scenario the importance of audit quality has emerged significantly. Though there is no universally accepted definition and perceptions about Audit Quality. However, IASSB is of the view that audit quality fundamentally has three aspects and each one is an important influence on audit quality. These three aspets are 1) inputs, 2) outputs, and 3) context factors. Firstly, inputs to audit quality are auditing standards, auditor’s personal attributes, auditor skill and experience, audit process, audit methodology etc. Secondly, Outputs of the audit is an auditor report which is used by
stakeholders to take an economic decision and the report also help the stakeholder in assessing the quality of audit. And Finally there are context factors that also influence audit quality like good corporate governance, transparent practices, ethical practices, and applicable financial reporting framework. So as per IASSB there are many things which influence the quality of audit. The influence can be both positive or negative.

Review of Literature
Many researchers have undertaken studies on the subject. Monroe and Woodliff (1993) examined the effect of education on auditing and marketing students’ perception about the responsibilities of auditors. The study found that both the classes of students perceived that auditors had more responsibilities and management had less responsibility for the prevention and detection of fraud, safeguarding assets etc. But, at the end of semester the auditing student believed that the auditor assumed a much lower level of responsibility, but there was little change in the marketing student’s beliefs. Elliott and Jacobson (1998) in their paper titled “Audit independence concepts” analyzed the role of audit independence to serve the audit to improve the reliability of information used for investment and credit decisions. The study concluded that the audit should not be immaterial because on their basis the investor and creditor were taking decision of investment. Lin and Chen (2004) found that the beneficiaries believed that the auditors were responsible for truthfulness and reliability of financial statements, detecting and reporting errors and frauds, liable for fraudulent or misleading information contained in prospectus and for any other inefficiency or irregularities more than management. Nath (2012) in his title “audit and Ethics: A complete protection measure for shareholder group” examined the ethics of the auditors and the corporate towards the stakeholder group. The study was based on the secondary data. The study concluded that to the existing framework and rules an addition in the form of mandatory code of ethics covering all the entities of a company, frequently follow up and speedy remedial actions, auditing of books of account twice a year etc. must be made. Oseni et al (2012) examined the level and nature of expectation gap between auditors and users of financial statements. The author suggested that the existing duties and responsibilities of auditors should be defined clearly and widened for fraud detection. Okafar and Otalor (2013) in their paper analyzed the role of auditing profession in narrowing the audit expectation gap. The authors were of the view that knowledge of public regarding the duties of auditors should be improved and also the standard auditor’s report must include in it disclaimer clause that the auditor’s opinion was not a guarantee of accuracy of the financial statements and also that he was not the compliance officer of the company.

Need of the study
A perusal of review of literature brings home the fact that a number of studies have been conducted abroad for understanding the audit, audit quality, perception about audit and audit quality from the perspective of common investors but limited studies have been conducted in India and most of the studies are related to perception of retail investors towards stock market so there is a need to conduct this study to understand perception and attitude of retail investors and determine the measures needed to improve investors’ confidence in the audit, audit process etc.

Objectives of study
- To study the awareness about the auditing scams in general and satyam scam in particular.
- To study the perception of investors the role and duties of auditor’s.
- To know about the expectations of the investors from the auditing process.
- To study the perception of investors towards the performance attributes of the auditors.
- To study the satisfaction level of investors from auditing and audit process.
- To suggest the measures to improve the audit quality and audit process.

Data collection and methodology
In this study, the primary data was collected using the tool of questionnaire. Questionnaire was developed and adapted by consulting relevant literature, and after having discussion and interaction with academicians, investors and financial securities analysts. The questionnaire has mainly used the
issues related to audit, audit process, audit quality etc. The questionnaire prepared comprised of both close as well as open ended questions to collect information on the different issues listed above. It was pre-tested on a group of 10 persons. The data has been collected from Chandigarh and nearby areas. A total of about 250 questionnaires were sent to investors located in the city using brokers, investor associations, internet groups & other contacts. A response of 112 questionnaires was received but out of the received questionnaires only 100 usable questionnaires could be obtained. The responses were obtained from those who were willing to spend their time & wished to contribute to the present research treatise.

Data Analysis and Interpretations

Investor’s Response to Awareness about Satyam Scam in particular and Auditing Scams in the world-

Investor’s response to this issue was analysed, it came to light that majority (84%) of the investors under study were aware about the Satyam scam however awareness about international auditing scams was found to be moderate (54%). The moderate knowledge of investors about international auditing scams was limited to the enron and worldcom scams. No other international auditing scams were named by investors. Among the 16% investors who did not have knowledge about these scams, majority were those investors who did not regularly invested in stock markets.

Investor’s Response to Investments in Satyam and liquidation of investments in Satyam -

The study revealed that 33% of the total respondents base had investments in Satyam the top reasons cited by investors for investments in Satyam were track record, awards like golden peacock etc. Among the 33% respondents who had investments in Satyam, all of them liquidated their investments immediately after the scam came to light. Also all the investors reported making a loss because of sharp decline in the stock prices.

Investor’s Response to the query who was responsible or at fault in the case of Satyam.

The respondents were asked to indicate who they thought was at fault in case of satyam case. The study revealed that majority (71%) of the investors under study feel that auditors were at fault completely. This was followed by company officials and lastly investors surveyed mentioned government and its procedures, regulations, conduct etc. at fault.

Analysis of Responses on Audit Quality, audit report and audit Process.

Investor’s Response to the issue concerning audit quality.

40% of the investors agree that quality of audit has improved in the recent years out of which 17% of the respondents strongly agree to it. In contrast 20% of the respondents disagree that quality of audit has improved, 36% strongly disagreed with it. The investors who either Strongly disagreed or disagreed were primarily those investors who have suffered losses on account of their investments in Satyam. It can be summarized from the study that the attitude of the investors is not positive because of scams taking place every now and then. This has resulted in a perception among them that the quality of audit has not improved.

Investors Response to the Query that “ Are auditors becoming puppets in the hands of management”.

Investors response to the above issue that auditors are more concerned with keeping the management of the company i.e, client’s company satisfied and happy which sometimes make them ignore their basic duty of presenting the true and fair view of business was analyzed and the study found that 63% of the respondents agree that auditors are too concerned in keeping the company management happy. 22% strongly agreed and 18% disagreed with it. On the whole examination it is clear that majority of the respondents agree that auditors are more concerned in keeping the company happy and satisfied. The primary reason for it could be higher consultancy fee, renewal of audit contract etc.

Investors response to utility of audit in facilitating decision making

In this question the investors were asked to give their opinion on that whether audit has a utility in facilitating decision making for company, investors or it is useful to both ie, company and investors. Data analyzed indicated that 47% of the respondents disagree that audit is of very little utility to the company and 24% strongly disagree to it. So it can be interpreted that investors feel that audit is a
significant and integral part in decision making and most of the respondents consider it to be beneficial to both the company and investors.

**Investors response to the query that Auditors have only perspective on financial report and not on management/ business problems.**

The result show that 6% of the investors strongly agree and 26% of the investors agree that auditors have no perspective on the problems faced by business or management. This shows that the out of the total investors 32% perceive the duty of auditors correctly of only checking the financial results and submitting in its report whether it shows true or fair view of business. 24% of the investors disagree and 12% strongly disagree to the statement.

**Investors response to whether the auditor should comment and report the management inefficiency.**

An important purpose for which audit is done is to report material facts and findings and how the company is being run. 44% of the respondents strongly agree and 39% agree to the statement that the auditors must report management inefficiencies to the shareholders. Only 11% disagree. This may have been an immediate repercussion of the Satyam issue in India.

**Investors response to constitution and usefulness of intervention of the committee in audit process.**

An audit committee is an independent body answerable to the board and responsible for verifying that the operations of the company have been properly conducted and its books are kept in a proper manner. As audit committee is an independent body so 39% of the respondents strongly agree and 37% agree that audit committee should be constituted and as far as intervention of the audit committee is concerned 34% of the respondents strongly agree and 39% agree that as audit committee verifies the operations so its intervention is helpful in improving the quality of auditor's report. Only 5% disagree with it.

**Investors response to the various restrictions that are /should be levied on the auditors to improve discharging of basic duty of auditing accounts.**

The various restrictions on which the opinion of investors was sought were: a) Auditors should not own share in client company, b) auditors should only provide auditing service to client and not other services, c) auditor should audit account of a company for a limited period, d) auditor should audit account of a company for a limited period.

Auditors should not own share in client company, If the members of the audit firm will indulge in any kind of the insider trading or have internal control over the operations of the company, then they cannot be fair in their dealings. So 30% strongly agree and 51% agree to the statement that auditors should not own share in client company i.e. whose account they audit. Investors response to that auditors should only provide auditing service to client and not other services, 28% of the respondents strongly agree to the above statement an 38% agree to it that audit firm should not provide any other service. Out of the various service investors have mainly named that auditor should not provide management consultancy to client because the basic role of auditor is to verify the books and not to provide management or advisory services. Investors response to the auditor should audit account of a company for a limited period. 20% of the respondents strongly agree and 40% agree that audit firm shall have a maximum period of office after which reappointment shall be made and the old auditor should not be allowed to be reappointed. However, 8% disagreed and 3% strongly disagreed to the statement.

**Investors response to present level of service provided by auditor with special reference to the issues of identifying and diagnosing the problems area.**

Data analyzed revealed that 8% of the respondents consider that the respondents are extremely successful in diagnosing the problems. 31% consider them successful whereas 24% are neutral about the opinion, 31% consider them unsuccessful and 6% consider them to be extremely unsuccessful in diagnosing the problems. Investors know that the main duty of the auditors is to analyze the book but in the recent past they have not been able to diagnose the problems.
Investors response to auditors must subordinate individual interest to public interest.
40% consider auditors to be unsuccessful in acting independently 13% consider auditors to be extremely unsuccessful i.e. they do not subordinate individual interest to public interest. So we can say that investor of today perceives the auditors are not subordinating individual interest to public interest.

Investors response to the query that auditors communicate effectively and efficiently the financial results and other important information to all stake holders.
The data analysis shows that 28% of the respondents feel that auditors are successful in communicating the results and findings to the stake holders but 18% feel neutral about it whereas 30% regard them as unsuccessful and rest 24% consider them extremely unsuccessful. So it can be summarized that investors feel that auditors do not communicate the results effectively. The investors are of the opinion that if this would have been the case, then the Enron, Satyam scam etc would not have taken place.

Investors response to that auditor’s report truthfully in all situation
The data analysis shows that only 17% of the respondents feel that auditors are extremely successful in reporting truthfully the results to the stakeholders. But 16% feel neutral about it whereas 33% regard them as unsuccessful and rest 33% extremely unsuccessful. So it can be summarized that investors feel that auditors do not report the actual results and truthfully all the time.

FINDINGS OF THE STUDY
1. Majority of the investors under study were aware about the Satyam scam
2. Awareness about international auditing scams was found to be moderate.
3. The study revealed that majority of the investors under study feel that auditors were at fault completely in case of Satyam. This was followed by company officials.
4. Among respondents who had investments in Satyam, all of them liquidated their investments immediately after the scam came to light.
5. The study found that majority of the respondents agree that auditors are more concerned in keeping the company happy and satisfied.
6. Investors feel that audit is a significant and integral part in decision making and most of the respondents consider it to be beneficial to both the company and investors.
7. The study found that out of the total investors only 32% perceive the duty of auditors correctly of only checking the financial results and submitting in its report whether it shows the true or fair view of business.

EXPECTATIONS OF INVESTORS FROM AUDIT AND AUDIT PROCESS (BASED ON THE STUDY)
1. Auditors should not own shares in client company i.e. whose account they audit.
2. Auditor should audit account of a company for a limited period.
3. Investors expect auditors to gain more proficiency in diagnosing the problems in business.
4. Auditors must subordinates individual interest to common public interest.
5. Auditors must report the actual results truthfully to the stakeholders all the time.
6. Auditors must communicate effectively and efficiently the financial results and other important information to all stakeholders.
7. The investors have a general idea about duties and responsibilities of auditors.

RECOMMENDATIONS OF THE STUDY
1. The audit report should be made more informative.
2. The awareness and education campaigns about the duties and responsibilities of the auditors should be conducted.
3. The government should put in place a more robust system for monitoring and regulating the audit quality provided by audit firms.
4. Audit committees should be given more powers.
5. The auditors should be asked to pass through more rigorous professional training and education.
6. A quality assessing and accrediting organization should be set up like NAAC etc.
CONCLUSION

In conclusion it is submitted that the auditing process and systems is on the threshold of a momentous era of change. This is because the auditing industry is experiencing a period of dramatic change which has been brought to the light by breaking of scams both at indian and world locations. The battle of better audit quality has never been greater and it must intensify in greater measure in the near future. Only this will ensure a transparent, reliable, high quality, financial information been produced before the users specially the investors those who rely considerably on accounting and auditing functions for deciding a prospective investment.

Bibliography