



## Relevance of Audit Report in Decision Making

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**Abstract:** Lenders and investors use audit reports as part of their decision-making process. Research has revealed that the audit report has a positive impact on investors' decision-making, implying that a lack of proper audit reports will result in poor investment judgments. As a result, the audit report should be detailed and comprehensive because users rely on it to make economic and financial decisions. This study concludes that the audit report is certainly valuable for users when making decisions, as evidenced by the fact that it has an impact on investors' investment and financing decisions.

**Keywords:** Audit opinion, Audit report, Decision-making, Financial information, Value relevance

### 1. INTRODUCTION

Investors are rarely accessible to monitor a company's day-to-day operations; thus auditors are hired to function as a watchdog over the management. The purpose of auditing financial statements is to improve their credibility by providing reasonable assurance from an outside source that they give an accurate and fair perspective of the company and its affairs in accordance with accounting standards. As a result, investors may be assured that their funds are being used wisely and in their best interests (Olatunji & Osho, 2020).

Audit reports serve as a communication link between auditor and the users of financial statements; they aid users in actively making informed decisions, and they must grasp the substance of the report in order to apply it successfully. The audit report is crucial since it is required by banks and creditors before financing businesses. Shareholders and investment managers rely on audit reports for a variety of reasons, including market quality and risk portfolio (Oyededeji, Okere, Ogundana, Adetula, & Adesanmi, 2017).

Audit report is a report by an independent auditor who expresses his opinion on the true and fair state of a company's financial statements, which he examines primarily for the benefit of shareholders and other users. The audit report is the primary tool used by the auditor to transmit audited financial information about a company to investors and other financial statement users. The purpose of an audit report is to give users of financial statements reasonable comfort that the financial statements of an organization are free of substantial mistakes or misstatements (Goicoechea, Gómez-Bezares, & Ugarte, 2021).

According to Ghasemi, Nazari, and Noorani (2017), there is a link between the audit report and the financial information and the audit report is useful in presenting financial information. The audit report's financial information aids investors in making decisions. When reporting financial information to users, the audit report is considered a necessary tool. Many rely on audit reports to authenticate their information in order to attract investors, secure loans, and improve public appearance because many third-party users want financial information to be certified by independent external auditors. Financial information without an audit report, according to some, is "basically worthless" for investment reasons (Olatunji & Osho, 2020).

Likewise, Vaziri and Azadi (2017) suggested that financial information and the auditor's assessment are inextricably linked. The presence of vivid and reliable financial information, which is the result of a thorough reporting system, is regarded as one of the most important components in assessing a

company's status and function, as well as making decisions about the securities exchange issued by that firm.

Independent auditors, among other accounting professions, play a vital part in the evolution of accounting. They offer both assurance and attestation services. In addition, having underwriting services performed by a skilled independent auditor improves the quality of information available to decision makers (Putri, Adawiyah, & Pramuka, 2017). Thus, it is evident that the auditor's perspective must be objective. In auditing, independence refers to a neutral viewpoint in the execution of tests, the evaluation of test results, and the writing of audit reports.

Auditors verify the financial information, and users may rest assured that the information they are using is of high quality. The quality of auditors' work, as well as their comments, can help enhance the country's financial information system, allowing for better economic decisions (Hajiha & Feizabadi, 2013). Investors in emerging markets are requesting a more detailed audit report to help them make better decisions. An external auditor is needed to provide more precise and certified information (Oyedeji, Okere, Ogundana, Adetula, & Adesanmi, 2017).

Organisations go to tremendous lengths to get their accounts audited so that the auditors can express their own opinion on the organization's "true and fair perspective" of its financial status. Third parties look to the auditors' report for guidance when making decisions. As a result, it's imperative to assess the audit report's relevance in decision-making.

### 2. STATEMENT OF THE PROBLEM

Transparency in the financial industry suggests that the market has less information asymmetry. As a result, minimizing information asymmetry so that investors may make informed judgments should also be a top priority. Over the years, the relevance of an audit report in evaluating a company's financial records and spotting any risks has been emphasized. Thus, it is vital for this study to investigate other relevancies of the Audit report, particularly as it affects investors' investment and financing decisions.

Atila and Fatih (2017) opined that it is critical for investors to have correct and dependable information so that they can profit handsomely from their decisions. However, population increase, economic expansion, and the complexity of economic life have all eroded the reliability of the data supplied in recent years. Accounting and auditing services are requested as a result of the demand for precise and dependable data. The independent audit is also crucial in terms of investors, lenders, and business owners because it boosts the credibility of the information provided by the firm and the reports it creates.

### 3. METHODOLOGY

The importance and usefulness of audit reports in decision-making are demonstrated in this study. This study took a non-experimental method and primarily relied on the opinions of scholars. Through library studies, journals, and websites, the theoretical concepts and conclusions were constructed deductively. The availability of resources and expert opinion on the study justifies the use of the deductive constructions. Also, due to the limited time available for a complete study, this method was adopted. As a result, the method used could be subject to the accuracy or otherwise of different perspectives held by researchers whose work were relied on.

Desk review was carried out in this study. This was accomplished through gathering, organizing, and evaluating accessible information in order to acquire a better grasp of the context of the study. As a result, current literature on audit reports and decision-making was examined. Juneja (2012) noted that desk review is very effective since it is quick and inexpensive, and most fundamental information can be easily retrieved and utilized as a yardstick in the research process.

### 4. REVIEW OF EXTANT LITERATURE

Olatunji and Osho (2020) posit that the study of decision-making processes is important not only for explaining financial market dynamics, but also for assisting financial advisers in better developing their prescriptive advising activities. The investment decision refers to the decision made by investors or top-level management on how much money to put into investment opportunities. It is significant

because the financial statements issued by firms present accurate and timely information. Investors evaluate the financial status and operating results of companies before deciding whether to invest in their shares (Atila & Fatih, 2017).

Simply put, the investment decision is the selection of the type of assets in which the firm's capital will be invested. These assets are divided into two types:

1. Long-Term Assets
2. Short-term Assets

The decision of investing funds in the long term assets is known as Capital Budgeting. Thus, Capital Budgeting refers to the decision to invest cash in long-term assets. As a result, Capital Budgeting is the process of identifying an asset or investment proposal that would generate long-term profits. The first stage in Capital Budgeting is to choose the asset, whether it is existing or new, based on the future advantages it will provide. The next stage is to assess the proposal's level of uncertainty and risk. Because the benefits will be reaped in the future, the risk of returns is considerable.

A minimum rate of return must be established against which the long-term project's success can be measured. Working capital management refers to investments made in current assets or short-term assets. Working capital management is concerned with the management of highly liquid current assets. The decision to invest in short-term assets is critical for an organization's long-term performance, as short-term survival is required for long-term success. A company's working capital management aims to strike a balance between profitability and liquidity

If a company has insufficient working capital, or less money invested in short-term assets, it may be unable to pay off its existing debts, which could lead to financial loss. It might also hurt the firm's profitability if it has more current assets than it needs. As a result, a company's working capital must be optimal in order for its day-to-day operations to run smoothly.

Oyedeji, Okere, Ogundana, Adetula, Adesanmi and Lawal (2017) noted that the purpose of financial reports is to give relevant information to investors and resource providers as an essential component in lenders' and investors' decision-making processes.

Embong and Rad (2018) opined that when reported information is audited by a quality audit firm, it is more useful to decision-makers. The influence of audit transparency on investor decisions was investigated by Elliott, Krische, and Pecheer (2009). The findings showed that accounting transparency improves investors' capacity to respond, foresee, and appraise stock depreciation.

Antonio (2003) researched dealers and brokering companies and banks; the results revealed that users of audit reports see the information supplied in the auditor's opinion as beneficial and important when making decisions, both in terms of investing in and financing companies, as well as the amount of investment or loan to grant, according to the findings. The audit report was also deemed to be beneficial in making financial decisions.

Hsu, young and chu (2011) investigated the impact of the type of the auditor's report on company's share price behaviour in Taiwan and concluded that the type of audit has an impact on stock price movements. As a result, investors should avoid purchasing shares with negative returns because their audit reports are not acceptable.

Lee and Lee (2013) suggested that when compared to other institutions, audited financial statements audited by large institutions are of higher quality and contain fewer errors. Mihaela and Bogda (2015) conducted a study about the impact of audited reports on Romanian financial statements. The findings from ANOVA regression analysis revealed that regardless of the type of report and information from the financial statements, an audit by four (4) large firms and the information provided by the audit report has an impact on stock returns.

Ghasemi, Nazari, and Noorani (2017) indicated that the audit firm, asset efficiency, and the ratio of financial independence to asset efficiency all have a substantial link. In addition, companies that have been audited by major firms have more financial independence than organizations that have been audited by smaller firms. This result is consistent with (Banimahd & Ahmadi, 2013).

Shokri (2004) investigated the impact of the auditor's report on the decision of the users of financial statements. The study's findings revealed a significant difference between decisions made based on financial statements with an audit report and decisions made based on financial statements without an audit report.

Darabi and Jafari (2012) studied the impact of articles of independent auditor's report on financial reports' transparency of automobile and custom manufacture companies' group in 2003- 2009. The main finding of this study was that articles from independent auditor's reports promote openness in financial reports of companies listed on the Tehran Stock Exchange.

The study carried out by Alireza and Azadi (2017) on the impact of audit reports on financial information indicated that the type of auditor and the auditor's evaluation have a substantial impact on stock returns (financial information). The conclusions of this study agree with Robu and Robu (2015), who investigated the impact of the audit report on the relevance of accounting information reported by publicly traded Romanian companies.

Savad (2003) studied the impact of the auditor's report on the earnings per share, dividend per share, financial ratios of household appliances industry companies and machinery in listed companies in Tehran Stock Exchange. The findings revealed that decision-makers examine articles of reports in determining EPS and DPS, as well as having a correlation with articles of the auditor's report, and that they are vulnerable.

The performance of listed companies has also been proven to have a clear and positive association with the audit report. In a study carried out by Abdullahi, Norfadzilah, and Umaru (2020) on the impact of audit quality on the financial performance of listed companies Nigeria, presents that the financial success of listed firms in Nigeria is directly influenced by audit quality, as transparency in financial reporting leads to increased performance. Furthermore, the study found that auditor independence was favourably and statistically significant associated with Return on Asset. Auditor independence was found to have a greater impact on financial performance than auditor size.

## 5. DISCUSSION

Banks, creditors, and regulators all require an audit of a company's financial statements, therefore an audit report is usually required. However, in the actual world of investment decisions, the auditor's report's worth is sometimes questioned, as is the validity of the information contained in it for users making decisions. Despite the criticism, users of audit reports regard the information provided in the auditor's opinion as useful and critical when making decisions about investing in and financing organizations, as well as the amount of investment or loan to provide. Similarly, good auditing can improve the reliability of financial data, allowing decision-makers to rely on it more.

### 5.1. The Relevance of Audit and Audit Report

Umoren and Enang (2015) defined relevance as the ability of financial information to explain financial market indicators. The notion of a value-relevant element is the data or figure in the financial statement that leads investors in the valuation of shares. Before making investment selections, investors want to know which components have more relevant aspects in the financial statement. In reality, investors want to know which items have higher financial statement values for investing decisions. Several studies have shown that excellent auditing may boost the trustworthiness of financial information, allowing decision makers to rely on it more.

An audit is an independent review and expression of opinion on a company's yearly financial accounts. Audits are undertaken to ensure that the content and production of financial statements are in accordance with the standards, rules, regulations, and requirements (PCAOB, 2016).

According to PricewaterhouseCoopers (PwC), an audit assures users that management has faithfully portrayed a company's financial performance and position. In other words, the audit gives credibility to the financial report's information. Hussainey (2009), for example, shown that a higher quality audit increases earnings predictability. According to the findings of his research, Olagunju (2011) found that audit quality is related to the perception of financial statement credibility in Nigeria.

When making economic and financial decisions, stakeholders use the audit report as one of their major tools. Regulators, auditing standard setters, academics, and international organizations are

aiming to improve the information offered to stakeholders and promote audit quality and transparency by changing the structure and content of audit reports (Bédard, Coram, Espahbodi, & Mock, 2016). Similarly, Oyedeji, Okere, Ogundana, Adetula, and Adesanmi (2017) revealed that audit reports confirm the information contained in financial statements. Audited financial statements serve as a foundation for making investment and financial decisions.

The goal of audit reports is to help current and potential investors make informed decisions (Arens Elder & Beasley, 2012). The audit report, according to Al-Thuneibat, Khamees, and Al-Fayoumi (2008), acts as a communication channel between the auditor and the auditor's users. As a result, audit reports must be clear, objective, and customers must accept them as a trustworthy source of information. The impact of the information provided in these reports on investors' decision-making determines their usefulness; the information in the report supports users in making well-informed decisions.

Investors, financial analysts, and other groups of audit report users; financial directors, bankers, analysts, non-professional investors, and auditors themselves are all interested in audit reports (Gacheru, 2018). Kargin (2013) posits that if the information provided by a firm's financial statement has the ability to collect and analyze corporate value, it should be referred to as value relevance financial reporting.

Financial information is needed not just to evaluate a company's success, but also to comprehend how money invested in the firm has been spent and to assist those with an interest in the company in making informed decisions. Financial information that has been audited gets credibility. As a result, regulators should ensure that companies' obligations to publish audited financial information at regular intervals are upheld so that investors and lenders may make informed decisions (Gyau, Owusu, & Amaning, 2016).

## 5.2. Theoretical Consideration

### 5.2.1. Agency Theory

The relationship between two parties, investors and managers, is studied using agency theory. The principal (i.e. Investors) entrusts the agent (i.e. Manager) with particular responsibilities, and the principal entrusts the agent with compensation. Divergent objectives of different individuals are harmonized through a framework of contractual agreements, meaning that the directors' agency responsibility is to serve the shareholders as a governance function (Jensen & Meckling, 1976). The duty of the auditor, according to this theory, is to supervise the interaction between the manager and the owners. When the distribution of responsibility is not well defined, a gap expectation emerges. The regulation clearly defines each component's responsibilities. The manager and the owners must understand that the auditor is not responsible for the accounting, but only for ensuring that the auditing is carried out properly (Olatunji & Osho, 2020).

### 5.2.2. Credibility Theory

According to this theory, the primary function of auditing is to give credibility to the company's financial statements. Management uses audited financial statements as agents to increase the principal's trust in the agent's stewardship and reduce information asymmetry. The theory further noted that users benefit from enhanced credibility, which has a direct impact on the quality of investment decisions because they are based on accurate information. However, Porter (1990) concluded that investors' investment selections are not made primarily on the basis of audited information. Financial statements, on the other hand, are frequently said to have the purpose of validating or authenticating previously given signals (Hayes, Schilder, Dassen, & Wallage, 1999). Based on this assumption, several authors have concluded that investors do not consider audited information to be their primary source of investing information. Therefore, this theory does not address the other functions the investors expect the auditor to embrace regarding his attestation function.

## 5.3. Challenges of Audit Report



Auditors are required to obtain adequate relevant audit evidence in relation to audit reports and their professional duties because it assists them to minimize audit risk to an appropriate level, resulting in a positive expression of the auditor's opinion in the auditor's report. Although auditors make every effort to obtain sufficient acceptable audit evidence, this is not always the case, and they may be unable to collect evidence in sufficient quantity and quality in some circumstances. As a result, a common challenge to audit reports is the limitation on the scope of the auditor's activity or the scope of audit. These limitations may result from the following situations;

1. Limitations imposed or forced by management,
2. Limitations imposed by circumstances beyond entity's control,
3. limitations imposed by the nature and timing of audit procedures.

Simply, the foregoing refers to situations in which management prevents auditors from completing specific management functions, such as preventing auditors from receiving confirmations from an entity's clients, suppliers, banks, and so on. It can also refer to situations in which natural disasters, strikes, accidents, the destruction of financial records by fire, the loss of financial data due to system malfunction or corruption, or a hack attack occur.

Other limitations that pose a challenge to the Audit report are;

1. **Higher Cost Burden:** Due to Higher Cost Burden, the auditor limits his scope of work to selective testing or sampling thus in depth checking of books of accounts is not possible.
2. **Based on Test Checks:** Generally, an auditing exercise is based on test checking. Inferring a result on the basis of a test check always need not to be true.
3. **Insufficient Time:** In most cases, an auditor is expected to provide a report within a specific time frame. This timeline can sometimes make it difficult for an auditor to complete the auditing operation efficiently. This time constraint may limit the quantity of information available about events and transactions that occurred after the balance sheet date and had an influence on the financial statements. Furthermore, there is a time limit for resolving difficulties that existed at the time the financial statements were published.
4. **Based on Estimates:** Estimates are an inherent part of the accounting process, and no one, including auditors, can foresee the outcome of uncertainties. Estimate range from the allowance for doubtful accounts and an inventory obsolescence reserve to impairment tests of fixed assets and goodwill. An audit cannot add exactness and certainty to financial statements when these factors do not exist.
5. **Based on the Information Provided by the Management:** The audit opinion is based on the information provided by the management . Hence, outsiders cannot fully rely on the auditor's report.

An Audit report may also be a product of Fraud. This is a challenge for the most obvious reasons and considering that investment decisions are to be made based on Audit reports that have been founded on fraudulent activities, this might as well be the most fundamental challenge to Audit reports. The auditor as well as the management is responsible if a blatant fraud is ignored unless proven otherwise. It may arise due to management override of internal controls. The auditor has to set aside all assumptions and apply professional skepticism when carrying out their audit. The appropriateness of journal entries will ensure that there are less chances of collusion. Segregation of duties should be in place. Any inappropriate or unusual activity should be flagged. Any provision or accounting estimates should be thoroughly checked for fraudulent intentions and biases. Hence, a retrospective review of management judgments and assumptions related to significant accounting estimates is important. Various dedicated paragraphs in the audit report hold significance for the investors to judge a company. For example: The emphasis of the matter paragraph specifies certain matters of significance which the auditor might want to highlight. Thus, it indicates that there is no modification in the auditor's opinion in respect of the matters therein. But, it is important to know that particular fact.

The auditing fees itself are another challenge with audit reports. It goes without saying that in recent years, corporate management has turned to lower-cost, lower-quality auditing, eroding public trust in

audit reports. This is because the expense of conducting audits has increased considerably in recent years. This is attributable to a number of variables, including an increase in employee remuneration, professional indemnity insurance, increased technology costs, and the impact of changing audit methods and new accounting standards, which take time to learn and audit. (Kana, 2006; Schoole, 2006).

Clients, on the other hand, are often wary of audit price hikes that surpass inflation. According to Kana (2006), this forces auditors to do additional work without being rewarded, affecting the firm's long-term capacity to retain such clients. Moore (2003) writes in the CPA Journal about the problem that auditors face as a result of growing costs and lower fees:

*Efficiency is one thing, but audit fees have been so drastically reduced by factors such as bidding and price competition that firms have been forced to think of ways to reduce the time spent working on audits. Accountants are under pressure to fit the expenses of the job into the fees they can charge. Many of the firms involved in the continuing high-profile accounting scandals had their work papers done by firms that easily passed peer review. The auditors probably did their jobs efficiently, but didn't have the luxury of thinking about what might be wrong. Auditing fees should be high enough so that auditors can think on the job instead of quickly and mindlessly doing paperwork that will pass inspection.*

Audit fees should be set in a manner that will ensure an effective external audit, and added that the targeting of audit fees as a means of cost saving should be discouraged (Moloi & Adelowotan, 2019).

### **5.4. The Concept of Timeliness of an Audit Report**

According to Arowoshegbe, Uniamikogbo, and Adeusi (2017), timeliness occurs when information is made available to users as soon as possible. When information is provided at the right time, it has a greater impact and utility than when it is provided after a decision has been made. The timeliness of an audit report refers to how long it takes a firm to present its audited report to the public following the conclusion of its fiscal year.

Furthermore, Jim (2014) mentioned that timeliness is defined as the time between when data is expected and when it is easily available for usage. Timeliness is defined by the International Accounting Standard Board (2008) as making financial information available to users on a timely basis in order to influence their decisions. In accounting, the concept of timeliness is crucial. It emphasizes the need of making information available to decision makers while it is still relevant and valuable, despite being an old concept. The ability of decision makers to access information before it loses its relevance and ability to affect decisions is characterized as timeliness.

Ohaka and Akani (2017) opined that the most important information is timely information, which refers to the most current information. As a result, financial reporting timeliness is concerned with ensuring that financial information reaches the target financial statement users in a timely manner in order to present them with relevant and useful information for decision-making.

Research has shown the importance of audit reports being delivered and made available to information users on time. When there is a delay in sharing information, there may be an increase in information asymmetry Chue and lai (2007) and this would cause uncertainty in the decision-making process of investors Mohamad-Nor, Shafie, and Wan-Hussin (2010) and, as a result, have an effect on the decision-making of shareholders (both current and prospective).

Accounting standards setters around the world have identified the timeliness of financial reports as the overall important quality of financial information, and a delay in its distribution may result in expenses for both decision-makers and relevant users (Al Daoud, Ismail, & Lode, 2015). If financial statements are not available at a specific moment, they are no longer meaningful.

Ghasemi, Nazari and Noorani (2017) mentioned that accounting information should have qualitative properties such as relevance, reliability, comparability, and intelligibility to promote public confidence in listed firms on the stock exchange. For users to believe this financial information, the accounts must be audited. Transparency and high-quality financial information are critical in this situation because it is the foundation for investors' and creditors' best economic decisions.

Furthermore, managers may include personal decisions in financial reports in order to deceive shareholders about the firm's economic success and to make the organization appear flawless. As a result, audit plays an important role in providing high-quality data. In fact, auditing offers a framework for delivering transparent and valuable information.

### 6. CONCLUSION AND RECOMMENDATION

Throughout the audit report, the auditor's opinion serves as a middleman between the company and external users, influencing the shareholders' decision to invest or not. Investors, in particular, determine whether or not to invest in a company's stock by looking at its financial status and operating result (Atila & Fatih, 2017). The financial statements are regarded as a valuable resource not only for assessing the entity's performance, but also for gaining a better understanding of how funds invested in organizations were used and how they aided stakeholders in the entity in making informed decisions.

Users of audit reports see the information supplied in the auditor's opinion as beneficial and significant when making decisions about investing in and financing organizations, as well as the size of the investment or loan to grant. The audit report is undoubtedly valuable for users when making decisions, as evidenced by the fact that it has an impact on the users' investment and finance decisions.

Based on the foregoing findings, the following are recommended;

1. In the process of normal audit planning, they should try to determine the possibility of corruption through review of various regulations, rules and procedures,
2. Audit firms are advised to strengthen audit quality to ensure a boost in investors' confidence on firms' audit report content.
3. It is also recommended that the auditor's report content should be improved upon to a large extent to ensure full disclosure,
4. The timeliness of a report can also be improved on. Conscious investment decisions can only be made if the firm presents its audited report to the public following the conclusion of its fiscal year as soon as possible. This can only be achieved by a reform in the laws and legislations governing the audit process.
5. Lastly, the major limitations investigated under this study must be given attention. The management must ensure that auditors are not limited in obtaining relevant information to come up with reliable reports. Likewise, the cost of auditing can be regulated or reviewed so that more firms would get quality audit reports that are not necessarily a financial burden on their finances.

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