



The Influence of the Audit on the Quality of the Company's Financial Reporting

Ana Milijic¹
Andrija Popović²
Vanja Vukojević³

Received: January 27, 2025
Accepted: May 6, 2025
Published: June 2, 2025

Keywords:

Audit;
Financial reporting;
Business decision-making



Creative Commons Non Commercial CC BY-NC: This article is distributed under the terms of the Creative Commons Attribution-NonCommercial 4.0 License (<https://creativecommons.org/licenses/by-nc/4.0/>) which permits non-commercial use, reproduction and distribution of the work without further permission.

Abstract: *The financial collapse of world-famous companies at the end of the last and the beginning of this century actualized the problem of the quality of financial reporting. The factual situation is that manipulative actions most often occur in financial reports, where the practice of creative accounting reporting threatens to endanger not only the accounting profession but also mislead managers when making crucial investment decisions. Accordingly, the purpose of the work is to review the most important aspects of business and determine the spheres in which there is the greatest risk of materially significant errors. The subject of the work will be research and analysis of business situations that favor manipulations, as well as an assessment of the quality of financial reporting.*

1. INTRODUCTION

The term revision comes from the Latin word “revisio” which means re-viewing, renewal of the process or the last review before public disclosure. The word audit is not necessarily related only to the field of accounting and checking financial statements, this term is used every day during the control and checking of many activities in various spheres of both economic and social life. However, since the paper is about the audit of the company's operations, we can single out its definition according to [Kukoleča \(1990\)](#), “...The audit of financial operations includes a detailed examination of the entire operation in a certain period or an examination of a narrower part when it is necessary to accurately shed light on the true situation; when the existence of financial abuses is suspected or when it is necessary for management bodies for some special reasons” (p. 1319).

What is characteristic of the audit is that it is a set of activities that are coordinated and adjusted for each company individually, depending on the specifics of the type of economic activity, the size of the company, the way the business is organized, the ownership structure in the same, etc. A person who audits financial statements is called an auditor, and he/she must be a professional who possesses a set of intellectual knowledge and skills from the profession, which is also confirmed by the mandatory certificate of the title of authorized auditor and/or authorized internal auditor, among which the most prestigious certificates in the world are the AICPA (certificate of the American Institute of Certified Public Accountants) and ACCA (Association of Chartered Certified Accountants), while in Serbia they often acquire the title of certified auditor by taking an exam in the Chamber of Certified Auditors⁴.

Many individuals and world-renowned associations are involved in the improvement and improvement of auditing both in theory and practice. One of the more well-known is the above-mentioned

¹ University of Niš, Innovation Center, University Square 2, 18000 Niš, Serbia

² University of Niš, Innovation Center, University Square 2, 18000 Niš, Serbia

³ University of Niš, Innovation Center, University Square 2, 18000 Niš, Serbia

⁴ For more details, please see [Komora ovlašćenih revizora Srbije \(n.d.\)](#).

AICPA, whose Committee on Basic Auditing Concepts defines it as a systematic process of impartial collection, processing and evaluation of evidence about some facts related to business events. The aim of the audit is to determine the degree of correlation between the stated claims and some previously defined criteria, as well as to communicate the results of those comparisons to interested users. According to the IFAC (International Federation of Accountants) in the ISA (International Standards of Auditing), an audit is defined by its objective: “The objective of an audit of financial statements is to enable the auditor to express an opinion on whether the financial statements, in all material respects, compiled following the identified Financial Reporting Framework”. Based on the systematization of the previously mentioned definitions of audit, we can conclude that it represents a systematic process through which the auditor collects and evaluates information and evidence about business transactions and the results that certain business activities contributed to the economic entity so that after the completion of the audit process, an audit report is created as a “final product”, a report stating the auditor’s opinion.

There are four types of auditor’s opinions. We differentiate between positive, reserved opinion, dissenting opinion, and negative opinion. A large number of factors influence the formation of the auditor’s opinion, which will be discussed later. Before that, it is necessary to define the goal, subject and task of the audit.

The ultimate goal of the audit of financial statements is the preparation of an Audit Report in which the independent opinion of the auditor is presented. In order to reach the “final product” of the audit process, ie. audit opinion, it is necessary to go through two stages:

- the first phase represents the research phase in which the evidence is collected and evaluated, on the basis of which the audit opinion is formed
- the second stage - the reporting stage, in which the auditor presents his opinion to interested users of the information of the financial statements.

In order to make an opinion, the auditor must determine whether the financial statements have been prepared according to pre-established criteria. Something that decisively affects the auditor’s opinion is whether the financial statements are prepared in accordance with accounting standards, where we highlight the observance of IAS (International Accounting Standards) adopted by the IASB (International Accounting Standards Board). In order for the auditor to determine whether the financial statements have been prepared according to the aforementioned standards, it is necessary to collect and evaluate evidence. According to [Andrić et al. \(2009\)](#), “Evidence of the degree of agreement between the statements in the financial report and accounting standards can be found in accounting documents (invoices, checks, contracts, inventory lists, payment orders, receipts, etc.)” (p. 3).

The object of the audit also follows from the objective of the audit. The subject of the audit is business events that are recorded in the business books in the form of business transactions and that are always presented quantitatively whenever possible. Of course, on the other hand, there are business events that cannot be quantified due to their nature and are expressed qualitatively, where they are most often presented in the Annual Report on the company’s operations. Information that can be quantified falls within the domain of audit observation, while qualitative information is not the subject of the audit process.

The task of auditing arises from the need of the users of financial information for someone to verify the interpreted financial statements by the management of the company. Task auditing is not the compilation of financial reports, but rather instilling confidence in the objectivity, reliability and credibility of the entity’s presented financial reports.

2. REASONS AND NEEDS FOR THE AUDIT OF FINANCIAL STATEMENTS

First of all, we distinguish between internal and external users of financial statement information. Internal users include company employees such as managers, accountants and internal auditors. There are divided opinions about the shareholders (owners) of the company regarding their grouping into internal and/or external users. In addition to the owner, external users include investors, creditors (financial institutions), suppliers, customers, the Government and its agencies, as well as state bodies that deal with the control of law enforcement. The goal of all users is to receive reliable and objective information based on which they will make effective decisions and effectively meet the set goals. For example, company managers need to have constant insight into the realistic picture of the achieved goals concerning the set goals, and they get that information from the accounting department, which has the task of translating all accounting data about business transactions into appropriate business and/or financial reports. Based on these data, the efficiency of the company or certain segments of the company is evaluated by the management and further decisions are made. As for external users, if we take the case of an investor, his main goal is to invest capital while minimizing risk. Such a thing requires reliable information that has been verified by an independent third party, which is an auditor. By expressing his opinion, the auditor increases the certainty of the information provided by the financial statements. As early as 1972, the American Accounting Association (AAA, 1972, p. 25) illustrated the process of transferring information to end users:

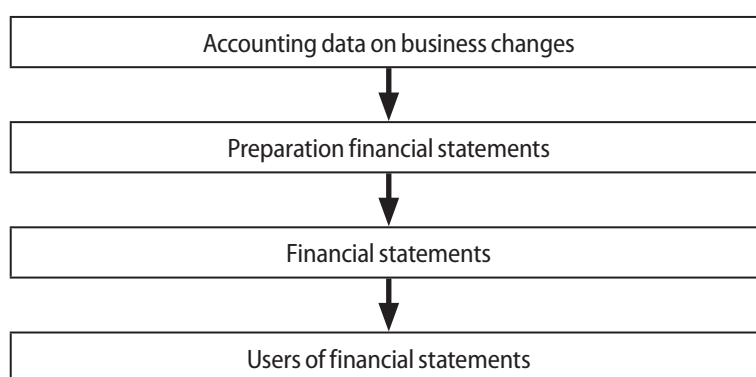


Figure 1. Transfer of accounting information

Source: American Accounting Association (1972)

Within this process of transferring information to end users, according to AAA (1972), there are five significant reasons for the need to verify financial statements:

- quality of information
- conflict of interest
- complexity
- distance
- consequences.

2.1. Quality of information

The quality of information is one of the key reasons for auditing financial statements. According to Andrić et al. (2009), auditing contributes to the improvement of the financial reporting process through two dimensions. The first dimension is information credibility and the second is control. Auditing is the process of controlling the existence and recording of business changes in the correct way following accounting standards, principles and adopted accounting policies. Subjecting financial statements to the audit process increases the credibility of accounting information and instills confidence in both

internal and external users in the reliability and accuracy of information from financial statements. On the other hand, the audit significantly affects the control of the quality of information from the financial statements because the audit is an independent external control (verification) of the accounting information and additional pressure is exerted on managers to pay special attention to objective financial reporting because they will be subjected to an independent external control (audit).

2.2. Conflict of Interest

The conflict of interest can best be explained by the classical phenomenon of the principal-agent problem.

The principal-agent problem is constantly present in large joint-stock companies, due to the separation of the function of ownership from the function of control. Owner-shareholders (principals) hire managers (agents) to make decisions and manage the company on their behalf. Managers are better informed about the company and its prosperity than shareholders. When one party is better informed about the activities of the other party, then the parties are asymmetrically informed. Due to asymmetric information, the owners do not know whether the managers, to whom they have delegated responsibility, act following their interests or ignore them, in favor of their interests. Company owners, as external users, usually get insight only into financial reports as a product of the company's accounting system. Based on information from financial reports, they make decisions about additional investment in a given company and/or reallocation of capital and also make decisions about the further fate of the company's management. It is already obvious that it is in the management's interest that the financial reports show the company's financial condition and success in the best possible light, because future managerial positions, salaries, bonuses and/or compensation packages will depend on it. Since management can influence the accounting system and presentation of information in its favor through various formal and informal procedures, independent external verification of claims from financial statements is approached to protect the interests of business owners.

2.3. Complexity

As the word itself says (complexity), it refers to the complex problem of translating business transactions into accounting information. This can lead to inadvertent errors in the incorrect accounting of ongoing business transactions. Sometimes it is very complex for users of information from financial statements to determine whether certain business transactions are presented reliably and objectively by the company's accounting system. For this reason, auditing appears as a reasonable solution for this type of problem. With his opinion in the Audit Report, the auditor verifies the information contained in the financial reports, so individuals as users of financial information don't need to burden themselves with understanding complex business transactions and their proper accounting inclusion.

2.4. Distance

Physical distance can be one of the reasons why individuals (competent to assess the quality of reporting on business events) and users of financial reports cannot independently decide the quality of information from financial reports. In addition to physical distance, there are sometimes certain legal restrictions due to which external users do not have the opportunity to personally determine the quality and reliability of information from financial reports, which imposes the need for an audit.

2.5. Consequences

Business owners, investors, financiers, suppliers, and other users of financial statements make decisions based on information from them. If the information non-objectively and unreliably shows the state and success of the entity, it will mislead the decision-makers, which will result in wrong decisions and significant financial consequences for them. Therefore, there is one more reason in favor of performing the audit process of financial statements.

3. FACTORS AFFECTING THE FORMATION OF THE AUDITOR'S OPINION AND THE IMPROVEMENT OF THE INFORMATION SYSTEM

According to the International Standard on Auditing (ISA) 700 (IAASB, n.d.), the auditor forms an opinion on the financial statements by considering whether they are prepared following the applicable financial reporting framework. To form an opinion, the auditor must be satisfied that he has obtained reasonable assurance that the financial statements, taken as a whole, are free from material misstatement, whether due to fraud or error. The auditor is expected to evaluate, based on his or her competence, whether the financial statements are prepared following the requirements of the applicable financial reporting framework in all material respects. According to ISA 700, this evaluation should include consideration of the qualitative aspects of the entity's accounting policies, including indicators of possible bias in management's judgment.

According to this standard, the auditor assesses (ISA 700):

- A) Whether the financial statements adequately disclose the significant accounting policies selected and applied. In making this assessment, the auditor should consider the relevance of the accounting policies to the entity and whether they are presented understandably;
- B) Whether the accounting policies selected and applied are consistent with the applicable financial reporting framework and are appropriate;
- C) Whether management's accounting estimates are reasonable;
- D) Whether the information presented in the financial statements is relevant, reliable, comparable and understandable. In making this assessment, the auditor should consider the following:
 - Whether the information that should have been included has been included and whether that information has been appropriately classified, aggregated or disaggregated and characterized.
 - Whether the overall presentation of the financial statements is marred by the inclusion of information that is not relevant or that makes it difficult to understand the matters disclosed.
- E) Whether the financial statements provide adequate disclosures designed to enable users to understand the effect of material transactions and events on the information contained in the financial statements; and
- F) Whether the terminology used in the financial statements, including the title of each financial statement, is appropriate.

Regarding the auditor's opinion as the final product of the audit process according to ISA and Generally Accepted Auditing Standards (GAAS), we distinguish the following types of auditor's opinion:

- positive opinion (opinion without reservation/affirmative opinion),
- opinion with reservation,
- dissenting opinion (abstention from opinion),
- negative opinion.

A positive auditor's opinion on the financial statements is issued when the auditor has a reasonable belief that the financial statements have been prepared truly and fairly and following the applicable Financial Reporting Framework. According to [Andrić et al. \(2009\)](#), the auditor's reasonable belief is formed by looking at the following questions:

1. whether the financial statements were prepared in accordance with the company's accounting policy,
2. that there were no restrictions during the collection of evidence in the audit process,
3. that the financial statements have been prepared in accordance with the legal regulations and the valid Law on Audit prescribed in the given country and if there are certain deviations, whether they have been presented in an adequate manner with a suitable explanation,
4. that all key information necessary to create a realistic picture of the company's financial condition and success is published in the correct way.

According to ISA 700, if the auditor:

- a) concludes that, based on the audit evidence obtained, the financial statements as a whole are not free from material misstatement; or
- b) is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement, the auditor should modify the opinion in the auditor's report in accordance with ISA 705.

The auditor will express a qualified opinion (opinion with reservation) when he notices that there are appropriate irregularities or some limitation in terms of scope, but it is not of such material importance that a negative opinion or abstention from opinion is made. These are usually balance sheet items that are important and must be mentioned in the auditor's report, about which there are disagreements in the matter of presentation in relation to the management of the company or there are corresponding problems in the matter of scope. However, in addition to the importance of that item to be mentioned in the audit report, it is not of crucial importance to express a negative opinion or for the auditor to refrain from an opinion. The question of the opinion with a reservation and the "importance" (materiality) of the balance sheet item is raised. The answer lies in the auditor's own professional judgment regarding this relationship. When composing of the auditor's report in which an opinion with a reservation is stated as an opinion, the auditor must have a position in which he precisely states the reasons for expressing a reservation regarding certain balance sheet items. There is common auditor terminology used when expressing a qualified opinion by using the expression "except for" on the matters to which the qualified opinion relates.

According to ISA, we express a qualified opinion when:

1. the auditor cannot obtain the appropriate scope of audit evidence,
2. the auditor's communication with legal representatives is limited or completely prevented by the management of the company,
3. the auditor is unable to obtain satisfactory evidence regarding a specific business event,
4. the disclosure was not made in an adequate manner,
5. if the management does not want to cooperate in providing the appropriate statements that the auditors require,
6. the auditor concludes that the level of detection risk cannot be reduced to an acceptable level.

Dissenting opinion. According to ISA 705 (p.3), "the auditor shall disclaim an opinion when the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, and the auditor concludes that the possible effects of undetected misstatements on the financial statements, if any, could be both material and pervasive." The auditor shall disclaim an opinion in extremely rare

situations involving a large number of uncertainties. The inability to obtain sufficient appropriate audit evidence may be due to restrictions imposed by management after the auditor has accepted the engagement. In such a case, if the auditor becomes aware of the restrictions imposed by management after the engagement, the auditor shall request management to remove the restriction so that the auditor may not express a qualified opinion or a disclaimer of opinion. If management refuses to remove the limitation, the auditor shall communicate this situation to those charged with governance, unless all those charged with governance are involved in the management of the entity, and determine whether alternative procedures can be performed to obtain sufficient appropriate audit evidence (ISA 705).

The auditor's negative opinion has as a consequence significant negative financial effects both on the state of the audit client and on his future business. Therefore, when the auditor expresses an adverse opinion, he must gather sufficient evidence to justify his decision to express the aforementioned opinion. By expressing a negative opinion, the auditor believes that the financial statements do not show the real financial situation, business results and cash flows because they are not compiled following accounting standards. In practice, negative opinions are a rare occurrence because clients generally accept the auditor's advice related to the true and fair presentation of business following accounting standards.

4. CONCLUSION

The opinion expressed by the auditor in his Audit Report can have significant both positive and negative financial consequences for the audit client. Given that in modern, unpredictable and dynamic business conditions, the audit is seen as an imperative for further business, management must make special efforts so that the final result of the financial statement audit process is a positive opinion of the auditor. To achieve this, management is expected to ensure an objective and fair presentation of financial statements as well as all business transactions. This is achieved by complying with the prescribed accounting standards and financial reporting standards, the national Accounting Law, by complying with the adopted Framework for the preparation and presentation of financial reports as well as the adopted accounting policies of the company. During the audit process, the auditors provide guidance to the company's management for the elimination of materially significant errors that lead to a negative opinion or abstention from an opinion. If the auditor's advice is adopted and materially significant balance positions are corrected that are not presented following the applicable Framework and/or ISA and do not reflect objectively and truthfully the state, success of the company and cash flows, the auditor will not express his negative opinion regarding the financial statements. In this way, the quality of financial reporting will improve, and in the future, audit clients will know how to treat appropriate business transactions and present them fairly and truthfully in their reports.

References

- American Accounting Association. (1972). *The Committee on Basic Auditing Concepts: A Statement of Basic Auditing Concepts*, Accounting Review – Supplement, Sarasota
- Andrić, M., Krsmanović, B., & Jakšić, B. (2009). *Revizija – teorija i praksa*, Ekonomski fakultet Subotica
- IAASB.(n.d.).*International Standard on Auditing (ISA) 700 (Revised): Forming an opinion and reporting on financial statements*. International Auditing and Assurance Standards Board. <https://www.iaasb.org/publications/international-standard-auditing-isa-700-revised-forming-opinion-and-reporting-financial-statements>
- Kukoleča, S. (1990). *Organizaciono poslovni leksikon izraza, pojmova i metoda*, Zavod za ekonomske ekspertize, Beograd.
- Komora ovlašćenih revizora Srbije. (n.d.). *Komora ovlašćenih revizora Srbije*. <https://www.kor.rs/>

Additional reading

- ACCA. (n.d.). *Qualifications at a glance*. Association of Chartered Certified Accountants. <https://www.accaglobal.com/gb/en/qualifications/glance.html>
- AICPA & CIMA. (n.d.). *Home*. <https://www.aicpa-cima.com/>
- Flint, D. (1988). *Philosophy and Principles of Auditing: An Introduction*, Macmillan, England.
- Gantz, S. D. (2014). *The basics of IT audit: Purposes, processes, and practical information*. Elsevier Inc.
- IFAC. (n.d.). *International Federation of Accountants*. <https://www.ifac.org/>
- IFRS Foundation. (n.d.). *International Accounting Standards Board (IASB)*. <https://www.ifrs.org/groups/international-accounting-standards-board/>
- Khan, M. A. (2019). *Role of auditing in reducing information asymmetry: A conceptual review*. SSRN. https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3433410
- KOR. (n.d.). *Komora ovlašćenih revizora*. <https://www.kor.rs/>
- Mohsin, H. J., & Abdulkareem, A. M. (2022). Role of external audit and its impact on improving the quality of accounting information – An analytical study in the opinions of a sample of leaders in the IBN Majid General Company. *Journal of Corporate Finance Management and Banking System*.
- Nagata, K., & Nguyen, P. (2017). Ownership structure and disclosure quality: Evidence from management forecast revisions in Japan. *Journal of Accounting and Public Policy*, 36(6), 451–467.
- Ricchlute, D. (1993). *Auditing: Principles and standards*. Boston.