

The Role of Audit Evidence Source in Enhancing the Quality and Reliability of Libyan Auditor's Report

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— Review of —
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ABSTRACT

Purpose- This paper explores the role of audit evidence source collected by Libyan auditor in enhancing the quality and reliability of its report.

Design/methodology/approach- A questionnaire was used to collect data regarding the perceptions of the external, internal, state and taxation auditors on the effect of the evidence source on the quality of auditor's report. To confirm and support the questionnaire findings semi-structured interviews were conducted with four target groups.

Findings- The results of the study indicate that source of evidence has an impact on the quality of auditor's report.

Originality- The research makes a significant contribution to knowledge and practise in the auditing field in emerging countries. This is especially important given the changing economic climate in Libya and findings from this research can be applied to other emerging economies.

Keywords- Libya, Audit Evidence Source, Quality of Auditor's Report, Emerging Countries.

Introduction

Auditor reporting quality is a basic ingredient to enhance the credibility of financial statements to those interested parties. However, "the quality of audit opinion lies in that of the judgements the auditor makes these in turn dependent on the quality of the evidence that has been gathered and the quality of the people gathering it. Ultimately, auditors provide a quality service to shareholders if they provide audit reports that are independent, reliable and supported by adequate audit evidence" (ICAEW, 2002, pp.7-8).

Accordingly, many studies have been conducted on the quality of audit opinion and audit evidence source including, Glover et al., 2004; Kizirian et al. 2005; Gronewold, 2006; Jarboh, 2006; McDaniel and Simmons, 2007; Payne and Ramsay, 2008; Kaplan et al., 2008; Zhang et al., 2009; Marris, 2010; Zakari, 2013. The majority of these studies tend to be related to developed countries. As a result there are only a limited number of studies which address the issues that developing countries have in attempting to improve their professional accountancy and auditing practices (Faraj and Akbar, 2010; Michas, 2010). Glover et al. (2004) and Jarboh (2006) all draw attention to the specific need to focus on audit evidence in particular relating to the quality of auditing report. Thus, this paper investigates the extent of the sufficiency and appropriateness of audit evidence used by Libyan auditors as part of the auditing process. In particularly, it focus on answering this question: *Does audit evidence source obtained by Libyan auditor effects on quality of its report?*

The remainder of this study is organised in 7 parts. Section 2 critically reviews the literature on audit evidence sources and their effects in auditor's report. The methodology utilised to examine the research question is provided in section 3. Section 4 presents the results of the data obtained from the study questionnaire and interviews. Then, the paper discusses the results of the empirical study in section 5. The next section provides the conclusion. The final section presents the study limitations.

Literature Review

The crux of audit work is the collection and the evaluation of evidence (Abou-Seada and Abdel-Kader, 2003; Rittenberg et al., 2009). Auditing standards suggest that the auditors should obtain evidence to support their opinions (IFAC, 2010a) and it is also argued that audit evidence is the substance of the audit process (Soltani, 2007).

In 2010, the International Auditing and Assurance Standards Board [IAASB] updated two standards in relation to audit evidence (IFAC, 2010a). These two standards are: ISA 500 '*Audit Evidence*' and ISA 501 '*Audit Evidence-Additional Considerations for Specific Items*' (IFAC, 2010). The ISA 500 requires the auditors to meet an expected minimum standard in relation to the audit evidence that they gather and base their professional opinion upon (IFAC, 2010a). The second standard, ISA 501 provides additional guidance to support ISA 500 so that auditors have examples along with defined testing criteria for specific items (IFAC, 2010a). The specific items discussed in ISA 501 include evidence for financial statements account balances and disclosures (IFAC, 2010a).

The persuasiveness or quality of audit evidence depends on the reliability of its source (Gronewold, 2006; Missah, 2008). According to Goodwin (1999) the independent source is perceived by the auditor as more credible than the non-independent source, but to confirm the reliability of this source, the source should be known to the auditor. The ISA 500 (2010a) stated "*Audit evidence obtained from an independent source may not be reliable if the source is not knowledgeable*" (IFAC, 2010a: Para. 4).

Several studies in the auditing area have indicated that the competence and the objectivity of the source is an important determinant of persuasive power of the evidence (Payne, 2004; Payne et al., 2007; Marris, 2010). However, Rose and Rose (2003) advise that it is not always possible to determine the validity of specific information or its source.

According to Janvrin (2001) and ISA 500 (2010a), the auditors should assign greater persuasiveness to evidence from external parties than to evidence from internal parties. However, the auditors may be unable to collect evidence from external parties. There could be delays in obtaining responses to requests for information and as a result the auditor may be compelled to rely on internal sources for gathering audit evidence (Caster and Pincus, 1996). ISA 330 (2010d) '*The Auditor's Responses to Assessed Risks*' directs auditors to maintain an attitude of professional scepticism when they integrate information provided by management into their auditing judgments (IFAC, 2010).

According to Salterio and Koonce (1997) and Agoglia et al. (2009) audit team members placed more weight on information originating from other audit team members than information from client personnel. Anderson et al. (2001) and Al-Angari (2006) pointed out that auditors are sensitive to the objectivity of the source of evidence. Auditors consider evidence from a fellow auditor to have a higher standard of quality than evidence from the entity's management, because the fellow auditor is

seen as more objective than client management (Salterio and Koonce, 1997). Kizirian et al. (2005) found that management integrity exhibits incremental explanatory power beyond the risk of material misstatement for the persuasiveness of audit evidence collected.

The previous studies about auditors' perception of evidence generated from the accounting system of the entity indicated that auditors were more willing to rely on evidence from the accounting system of the client when there is internal control effectiveness in supporting their opinion (Salterio and Koonce, 1997; Agoglia et al., 2009).

Research Methodology

Creswell (2009) indicated that the most common and well-known approach to mixing methods is the triangulation design. Creswell and Clark (2007: p.18) state that "*Triangulation research is important today because of the complexity of problems that need to be addressed, the rise of interest in qualitative research, and the practical need to gather multiple forms of data for diverse audiences*".

Given the growing body of opinion favouring the use of multi-methods in obtaining or analysing data (Saunders et al., 2009), triangulation was used in this study as a method for collecting and analysing study data.

To answer study question which is ***Does audit evidence source obtained by Libyan auditor effects on quality of its report?***, self-administered questionnaires were used to collect data concerning the perceptions of external, internal, state, and taxation auditors about the relationship between evidence source and auditor's opinion. Statistical analysis by using Statistical Package for Social Sciences (SPSS) version 17 was undertaken on the resulting data.

To confirm and support the questionnaire findings semi-structured interviews were conducted with 12 Libyan auditors. This process enhanced and supplemented the questionnaire findings providing in-depth clarification and understanding of the effects that the evidence source has on auditor's report. Content analysis was used to analyse the collected data from the interviews.

The first part of the questionnaire was designed to obtain some personal information of participants relating to their background. The second section was designed to collect the opinions and views of Libyan auditors regarding the effects of the source of evidence on auditor's opinion. The third section of the questionnaire used an open question to enable the participants to provide the researcher with additional information which they felt would help the study.

A 5-point Likert-scale ranging from strongly undermines quality auditor's opinion to strongly enhances quality auditor's opinion was utilised to measure perceptions regarding auditor's opinion.

In this study the random sample method was used because there is a sample frame, and it was also more representative of the current Libyan auditor population (Sekaran, 2003). Moreover, Hussey and Hussey (1997) indicated that a representative sample should be large enough to satisfy the need of the study and should be chosen at random and be unbiased. Thus, 70% of the external auditors at Libyan Accountants and Auditors Association [LAAA] in Tripoli city and 80% of the state auditors at Institute of Public Control [IPC], and taxation auditors were included in the sample selected for this study. For the internal auditors, all auditors at 8 Libyan major banks were used as participants for the study sample. Consequently, a sample size of 288 auditors was selected from the four target groups (81 external, 77 internal, 67 state, and 63 taxation auditors) out of the 387 auditors making an overall percentage of 74%.

Analyses and Results

Descriptive statistics were used to analyse the background information of participants such as gender, age, years of experience. 90.9 % of the survey participants are males aged between 21 to 50 years, while there was only 9.1% female participants. It is interesting to note that the majority of the female respondents were less than 40 years of age (See Table 1).

Table 1. Percentage distribution of auditors by qualification achieved

	External Auditor		Internal Auditor		State Auditor		Taxation Auditor		Total	
	No	%	No	%	No	%	No	%	No	%
Auditors' gender										
Male	49	96.1	47	92.2	35	79.5	39	95.1	170	90.9
Female	2	3.9	4	7.8	9	20.5	2	4.9	17	9.10
Total	51	100	51	100	44	100	41	100	187	100
Auditors' age										
21- 29 years	17	33.3	17	33.3	18	40.9	15	36.6	67	35.8
30- 39 years	17	33.3	20	39.2	23	52.3	20	48.8	80	42.8
40-50 years	11	21.6	11	21.6	3	6.8	6	14.6	31	16.6
Over 50 years	6	11.8	3	5.9	0	0	0	0	9	4.8
Total	51	100	51	100	44	100	41	100	187	100
Auditors' education level										
High School	1	20.0	11	21.6	5	11.4	1	2.4	18	9.6
First University Degree	33	64.7	35	68.6	28	63.6	36	87.8	132	70.6
Masters Degree	12	23.5	4	7.8	10	22.7	4	9.8	30	16.0
PhD	5	9.8	1	2.0	1	2.3	0	0.0	7	3.7
Total	51	100	51	100	44	100	41	100	187	100
Auditors' education subject										
Accounting	50	98.0	43	84.3	28	63.7	28	68.3	149	79.7
Management	1	2.0	3	5.9	6	13.6	3	7.3	13	7.0
Economics	0	0.0	5	9.8	10	22.7	10	24.4	25	13.3
Total	51	100	51	100	44	100	41	100	187	100
Auditors' years of experience										
Under 5 years	9	17.6	8	15.7	3	6.8	6	14.6	26	13.9
5- 9 years	10	19.6	19	37.3	11	25.0	14	34.1	54	28.9
10- 14 years	11	21.6	9	17.6	21	47.8	14	34.1	55	29.4
15-19 years	8	15.7	7	13.7	7	15.9	5	12.2	27	14.4
20-24 years	13	25.5	8	15.7	2	4.5	2	4.9	25	13.4
Over 24 years	0	0.0	0	0.0	0	0.0	0	0.0	0	0.0
Total	51	100	51	100	44	100	41	100	187	100

Table 2 shows the results of frequency and percentage for evidence source items and their effects on auditor's report. At least 60% of participants' answers were between slightly enhances auditor's opinion [STEAO] and strongly enhances auditor's opinion [SLEAO] categories, such seen in items no. 1, 2 and 8.

Table 3 shows the results of means for evidence source items. The overall mean (3.91) indicated that auditor's opinion was perceived by Libyan auditors to be enhanced such as statements no. 1, 2, 7 and 8. The standard deviations ranged from 1.059 to 1.981.

Three key points were discussed in the interviews in relation to the effects of evidence source on auditor's opinion:

- The audit evidence from independent, unknowledgeable, and different sources.

- The evidence obtained from previous audits, from other audit team members, and from fellow auditors in other firms.
- The data generated by the accounting system of the entity as evidence.

Table 2. Frequency and percentage results of questionnaire

No	The Statements	STUAO*		SLUAO**		N***		SLEAO****		STEAO*****	
		No	%	No	%	No	%	No	%	No	%
1	The auditor obtains evidence from independent sources	1	.5	9	4.8	20	10.7	42	10.7	115	61.5
2	The information is collected from different sources	3	1.6	11	5.9	8	4.3	51	27.3	114	61.0
3	The source of evidence is not knowledgeable	79	42.2	33	17.6	74	39.6	1	.5	0	0
4	The auditor uses evidence obtained from previous audits	8	4.3	11	5.9	18	9.6	86	46.0	64	34.2
5	The auditor uses information originating from other audit team members	3	1.6	11	5.9	12	6.4	76	40.6	85	45.5
6	The auditor obtains evidence from fellow auditors in other firms	10	5.3	17	9.1	49	26.2	85	45.5	26	13.9
7	The auditor uses data generated by the accounting system of the entity as evidence	0	0	2	1.1	20	10.7	44	23.5	121	64.7
8	The auditor uses data produced by computerised information systems	0	0	1	.5	24	12.8	89	47.6	73	39.0

Sample Size = 187
 *STUAO = Strongly Undermines Auditor's Opinion (1)
 **SLUAO = Slightly Undermines Auditor's Opinion (2)
 ***N = Neither (3)
 ****SLEAO = Slightly Enhances Auditor's Opinion (4)
 *****STEAO = Strongly Enhances Auditor's Opinion (5)

Table 3. Means results

No	The Statements	Mean	Std. Deviation
1	The auditor obtains evidence from independent sources	4.40	1.981
2	The information is collected from more than one source	4.40	1.314
3	The source of evidence is not well-informed	1.98	1.258
4	The auditor uses evidence obtained from previous audits	4.00	1.129
5	The auditor uses information originating from other audit team members	4.22	1.864
6	The auditor obtains evidence from fellow auditors in other firms	3.53	1.109
7	The auditor uses data generated by the accounting system of the entity as evidence	4.52	1.059
8	The auditor uses data produced by computerized information systems	4.25	1.243
Overall mean		3.91	

Regarding the first point, most interviewees explained that the source of evidence is a very important issue which should be considered when the auditor collects and evaluates audit evidence to support s/he report. They suggested that evidence could be

collected from internal or external sources, each type of which has different effects. In this aspect, seven interviewees agreed that independence and external evidence is more reliable than internal evidence. Commenting on this issue, one of the external auditors stated that:

“As an external auditor, and from my past experience, the reliability of evidence source is a very important factor affecting the auditor's opinion. Thus I think that evidence obtained from third parties such as bank confirmations is more independent and reliable than that collected from client is records. Therefore, for me, I rely on evidence obtained from third parties rather than internal evidence” (External Auditor 1).

However, a third of the interviewees (4/12) indicated that in some cases, the external and independent source is not credible, and fair. Therefore, they suggested that the auditor should collect evidence from different sources. For example:

“Regarding the reliability of external sources of evidence, in some cases, I noticed that the expert's written representations were not fair, because it was inconsistent with the information that I collected from the reliable sources” (Internal Auditor 8).

“The multi-sources of evidence give the auditor more confidence to draw his/her opinion about the reliability of financial statements of clients audited” (External Auditor 2).

With regard to the knowledge of the source of evidence, all interviewees pointed out that the auditor should obtain evidence from a source that is knowledgeable and supported by the laws.

“The internal auditors in the banking sector rely on evidence from legal sources such as the laws issued by Libyan Central Bank” (Internal Auditor 8).

The second point discussed in the issue of source of evidence was the evidence obtained from previous audits, from other audit team members, and from fellow auditors in other firms. 11 interviewees explained that these sources have a high level of persuasiveness and quality. Thus, they stressed that the auditors rely on evidence collected from previous audits, from other audit team members, and from fellow auditors. The following are some quotations in this area:

“As an external auditor, I know, most of the evidence obtained from auditing area as last years' workpapers are more objective. I think that is because that most of the external auditors work has a high level of credibility” (External Auditor 2).

“From my prior experience in auditing, the work of auditors of internal department of the bank is a great source of evidence” (Internal Auditor 8).

“Like most of the banks in Libya, we believe that the internal audit report is a better source of evidence for errors by the bank accountants” (Internal Auditor 9).

“I do not strongly agree that the work of fellow auditors in other firm is a strong source for evidence but it could be used as evidence” (Taxation Auditor 11).

The third theme that was covered in the interview was regarding the reliability of the accounting systems, a large proportion of the interviewees (9/12) agreed that the accounting system of a client is an acceptable source of evidence. For example:

“Like most banks in Libya, the accounting system of the bank is the important source for collecting evidence to support the internal auditor report” (Internal Auditor 9).

“As an internal auditor, I think that the accounting system of a client is an available and is a better source for collecting evidence about the extent of the validity of accounting operations” (Internal Auditor 8).

One of the external auditors mentioned that:

“In my opinion, the information collected from the accounting system of the entity is a primary source of evidence for external auditors” (External Auditor 3).

However, other three interviewees stressed that the auditor should not completely rely on the evidence generated by the accounting system of entity in their opinion about fairness of financial statements before testing the accounting and internal control systems. The following are some comments on this issue:

“For me I can say that before relying on the accounting system as evidence source, I have to obtain an understanding of the internal control system and evaluate to what extent this system is effective” (Taxation Auditor 12).

“I cannot place complete reliance on the evidence generated by the accounting system, because, the accounting system is under the control of the client’s management. Thus, as a tax expert, I do not feel more confident when I rely on this type of evidence in evaluate the tax” (Taxation Auditor 10).

“The external auditor should test the accounting system of the client before reliance is placed on any data collected from it” (External Auditor 2).

The evidence from these interviewees indicates that Libyan auditor used the data generated by the accounting system as audit evidence to support their view about the credibility of financial statements. Interviewees agreed that the sufficiency and appropriateness is enhanced when the evidence was collected from a strong accounting system.

Discussion

From the questionnaire results the respondents indicated that 72.2% of auditors agreed that it is necessary for the auditor to obtain evidence from independent sources while large percentage (88.3%) confirmed that information must be collected from different sources to provide a range of evidence types and an overview of the organisation being audited.

The questionnaire respondents perceived that the auditor's opinion is enhanced when the evidence was obtained from independent and different sources. These findings are consistent with the results of Caster and Pincus (1996) in their study of Bentham’s (1827) theory of persuasiveness, who found that the persuasive value of evidence perceived by participants (senior auditors) increased, when evidence was provided by an independent party and not by client personnel. The interview participants confirmed this previous research and the questionnaire results for the independent and different sources with a 70% agreement that independent and different sources. However while there was agreement that external evidence is required there are issues in the collection of this evidence. Joshi and Deshmukh (2009) identified that it can be difficult in developing Arab countries to gather external evidence due to delays, reliability and infrastructure limitations.

A total of 59.8% of the respondents in the questionnaire expressed that they believe that the lack of knowledge ability of the source impacts on the quality of the evidence. Yet on this same question the respondents indicated that 39.6% provided a

neutral comment. This response in the questionnaire reflects the ISA 500 (2010) standard that states that if the source of the evidence is not knowledgeable the evidence may not be reliable. The interview response confirmed the questionnaire with 100% of respondents stating that evidence is undermined when it is collected from unknowledgeable sources. This result is consistent with several studies which have found that evidence collected from external independent sources is more objective than evidence obtained from internal and unknowledgeable sources in supporting auditor's report and indicated that the competence and the objectivity of the source is an important determinant of persuasive power of the evidence (Payne, 2004; Ross and McHugh, 2006; Marris, 2010).

The second points addressed in the source of evidence and its effects on auditor's opinion were the evidence obtained from previous audits, from other audit team members, and from fellow auditors in other firms. The survey results showed that the auditor's opinion perceived to be enhanced by 80.2% when the evidence is obtained from previous audits and 86.1% perceive that information originating from other audit team members is highly valued in the audit process. The interviewees (92%) stressed that the auditors rely on evidence collected from previous audits, from other audit team members, and from fellow auditors. The high percentage for the response was consistent for previous audits and other audit team members. There was a discrepancy in the results between the questionnaire and the interview for obtaining evidence from fellow auditors in other firms. The survey response was only 59.4% for evidence from auditors in other firms. The survey response was consistent with previous studies in this area (e.g. Salterio and Koonce, 1997; Anderson et al., 2001) who found that auditors considered evidence from a fellow auditor and from previous audits to be more persuasive than evidence from client management, and they put more weight on information originating from other audit team members than information from client personnel.

From the responses of the interviewees it appears that it is their years of experience which is influencing their perception. It was only one taxation auditor who did not agree and this could be as a result of with professional working area. Taxation auditors in Libya have legislative support with gives them the authority to demand information from other external organisations, also the role of a taxation auditor may over time through their experiences in assessing taxation may make them less trusting of anyone due to the nature of the work through their professional scepticism. Taxation authorities in Australia according to Tyler (2001) have a low level of trust (negativity) in relation to the citizen's unwillingness to pay their taxation responsibilities. Due to the negative experiences of the Libyan auditors' work place it is possible that they have increased in their scepticism and have lower levels of trust when compared to the other professional groups due to their increased levels of response to professional assessed risks. The ISA 330 (2010) identifies that auditors need to maintain an attitude of professional scepticism and they should include that in their management of information for auditing judgements.

Kizirian et al. (2005) indicated that audit evidence that is generated internally is more reliable when the related controls imposed by the entity are effective. The results indicated that most questionnaire respondents (88.2%) perceived that data generated from the accounting system as a source of evidence while respondents (86.6%) regarded data produced by computerised information systems to produce evidence which provides high quality and quantities of information to produce highly reliable and valid auditing reports. A large percentage (75%) of the interviewees confirmed that the use of the accounting system and computerised systems were an

important source for collecting evidence. This high reliance on the accounting systems within organisations for evidence is inconsistent with the auditing professional standards from the ISA 500 (2010) which suggests that accounting records alone do not provide sufficient audit evidence on which to base an audit opinion. Joshi and Deshmukh (2009) highlighted that within Bahrain there are issues in the audit due to the poor accounting background of clients and inadequate internal control. If the system which the auditor is auditing has underlying issues such as poor accounting knowledge this is likely to create a marker for the auditor to question the internal control systems within the organisation.

The inconsistency between the Libyan auditors and the ISA 500 may be the result of the differences between developing and developed nations. Currently the majority of the accounting systems in Libya are not predominately computer based. The technology access has been limited by the economic embargo and accounting technology and know-how has been imported from other countries through the influence of international oil exploration companies (Mahmud and Russell, 2003; Al-Badre, 2007; Alfaitori, 2007; Pratten and Mashat, 2009) With the lifting of the embargo in the 2004 (Otman and Karlberg, 2007) there has been infrastructure developments such as the implementation of computers in the workplace but the technological advances has not expanded into all settings. Not all employees have access to a computer on their work desk and this means that information may be recorded in traditional systems such as ledger books which are later transferred to a computer system for the whole of company accounts. The institutions which are fully computerised are those who are more likely to have direct contact with the international companies and their need to meet the international standards for accounting.

Conclusion: The research sought to answer the question *Does audit evidence source obtained by Libyan auditor effects on quality of auditor's report?*. Based on the results, the audit evidence source effects on the reliability and quality of Auditor's report in Libya.

Number of contributions to audit evidence theory and practice are made through this research. Initially, it is important to note that most previous audit evidence studies are based on quantitative methods. However this research has used both quantitative and qualitative method to ensure that 'triangulation' occurred in order to gain a clearer picture of how audit evidence is sufficient and reliable in supporting the auditor's decisions. Thus, this research adds a broader dimension to current audit evidence literature by the use of an additional technique to support future studies.

The study provided additional confirmation to the recent Faraj and Akbar (2010) which identified that further professional development of Libyan auditors needs to be undertaken including the implementation of International Standards on Auditing [ISA]. The study has provided additional evidence identifying the issues and conditions which need to be addressed and can be addressed by implementing the current best practice for auditors as contained in the ISA documents.

Limitations and Further Researches

The questionnaire was personally distributed; however, the researchers were merely acting as postmen. That is, in most of the cases, the questionnaire was handed out in the targeted firms, banks and state offices and collected at a later time. Therefore, the influences of the personally administered questionnaire could exist in this study but it was necessary to do this as there were infrastructure limitations that impacted on the study. The infrastructure issues combined with the large geographical area was a

limiting factor for the scope of the study. Libya's infrastructure issues include roads and transport links. This difficulty in accessing regional areas created by the geographical terrain and transportation issues created cost and access considerations. The study did not include other areas besides Tripoli the capital due to the infrastructure limitations and difficulties encountered.

Moreover, from the results there are a number of areas for source of evidence which needs additional research into why the Libyan auditors are responding in the manner in which they are. Anderson et al. (2001) states that auditors rely more heavily on the evidence of a more competent source yet for the Libyan auditors there was not the support that would have been expected. Why this occurs could be due to a number of reasons and through the study of organisational culture in Libya we may be able to answer why this aspect of source of evidence is not supported enough. The impact of organisational structures and cultures again was a possible reason why some Libyan auditors appear not to strongly support the evidence obtained from fellow auditors in other firms. Von Wielligh (2006) identifies that professional creditability and validity of the expert needs to be considered yet other studies indicated that similar professional membership made the auditor more likely to respect the opinion of fellow auditors in another firm (Anderson et al., 2001; Agoglia et al., 2009). The professional bias of one group, the Taxation auditors, needs to be investigated as why they were the group who seemed to be the most sceptical when interviewed. This scepticism could be because of their organisational culture or the nature of their work in the Libya context. Further study is needed to investigate the underlying reasons why this group appears to have greater scepticism than the other professional auditing groups in Libya.

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