

## **The Extent of the External Auditor's Reliance on the Internal Auditor's Report in Preparing the Report about the Financial Statements**

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### **Abstract**

*The study aimed to identify the extent of the external auditor's reliance on the internal auditor's report in preparing the report about the financial statements, the researcher has used statistical method (Spss) in analyzing the results of the study, The study found a set of results namely that the external auditor depends on the internal auditor's report when preparing the report on the financial statements, and that there are some problems that may face the external auditor when relying on the work and the report of the internal auditor, and that there is a difference between the work of internal and external auditors in writing and the preparation of the report and the internal auditor has role in facilitating the external auditing process. Based on the results of the study, it is recommended that the external auditor should verify the integrity and the transparency of the internal auditor and his commitment to the internal audit standards in preparing the report, and that the external auditor should take into account the present differences between his work and the work of the internal auditor, and that it is in favor of the external auditor and the external auditing process to activate the communication between him and the internal auditor in order to achieve a positive role in facilitating the external audit process.*

**Keywords:** external auditors, internal auditors, financial statements

### ***1. Introduction, Literature Review, & Research Question***

The importance of financial statements increases in our time as they are prepared for many purposes, including legal and administrative aspects, they also contain many figures that concern the different categories that read these statements such as investors, lenders and other groups that use to these statements in making financial decisions. At the same time the pace of the manipulation of the data and accounting figures is increased, as the boards of directors of these companies pursue to achieve self-gain. So the main objective of reviewing of these statements is to provide credibility and verification of the values contained therein to reassure its shareholders. Without the review, the information in the financial statements will be misleading or at least not reliable. Therefore it is important that the administration make every effort along with the supervisors in charge to prevent distortion and manipulation, and that includes the culture of honesty and ethical behavior. The management along with the supervisors in charge should show and demonstrate this culture based on a set of values which provide data for the individuals using it in terms of how the enterprises performs its business.

### ***2. Research problem***

The economic importance occupied by the auditing profession, and the large number of parties benefiting from its reports and the different interests of these parties, imposed on the auditor to possess the ability of being able to accomplish the task, which delivered the community to him.

The research problem could be formulated in the following questions:

What is the extent of the external auditor's reliance on the internal auditor's report in preparing the report about the financial statements?

What are the problems faced by the external auditor when relying on the internal auditor's report?

Are there difference aspects between the work of internal auditors and the external auditors in writing the report?

Does internal auditing have a role in facilitating external auditing process?

### **3. Research objectives:**

This research aims to find out the internal auditor relationship with the external auditor in the preparation of financial statements through the followings:

Identify the extent of the external auditor's reliance on the internal auditor's report in preparing the report about the financial statements.

Identify the problems faced by the external auditor when relying on the internal auditor's report in preparing the report about the financial statements.

Recognize the differences in the work of internal and external auditors in writing the report.

Identify the role of internal auditing in facilitating the external auditing process.

### **4. Research importance:**

The importance of this research emerges from the significance of interdependence between the internal and external auditors, where this interdependence among them is considered the cornerstone for the success of the profession in performing what is required, also the research is important because of the positive effects reflected on the performance of the profession and the promotion of social position due to the auditor's commitment to the general rules.

In light of what was presented accompanied with the foregoing financial and economic collapses and scandals of international companies and the loss of rights of the investors, shareholders and stakeholder and the companies' need to set up auditing committees whether internal or external auditing, so one could demonstrate the importance of the study.

### **5. Previous studies:**

Study of Alafifi (2009) entitled "The ability of the Internal Auditor through the application of professional performance standards of international internal auditing to confront the phenomenon of financial corruption in economic corporations." This study aimed to identifying the range the ability of internal auditor through applying the standards of professional performance in the general corporations to detect the financial corruption phenomenon. To achieve these objectives a questionnaire has been distributed to the general corporations depending at the previous studies and theoretical frame work, the distributed questionnaires were (35), the relict questionnaire were (34), which represent (97%) of which 3 were excluded for non-suitability for analysis. The study concluded the following findings: The reduction of the importance of internal audit in the general corporation at a great degree, the High costs of the application of the professional performance standards preventing its application at great degree. The study recommends that it is necessary to provide the internal audit with great importance in the general corporation. Also, it is necessary to reduce the application costs of professional performance so as to be applied to face the financial corrupt phenomenon.

Alshqar study (2008) entitled "Assessing the extent to which the external auditor are committed to examine the internal auditing work in accordance with international audit standard number (610)." This study aims at evaluating the compliance of the external auditor with International Standard on Auditing 610 when assessing the work of internal audit. The study was applied on the external auditors in Gaza Strip accounting 59. The researcher analyzed the questionnaires through the statistical model (SPSS) using various statistical tests and reached some conclusions, the most important of which are: There is a great commitment of external auditors in Gaza Strip to review internal audits in accordance with International Standard on Auditing 610. The Organizational Status of the internal audit function came first, the Scope of Function came second, internal audits Due Professional Care came third and Technical Competence came last. The study recommended enforcing the independence of internal audit function in organizations. The importance of professional societies interested in accounting and auditing and educational organizations to make internal and external auditors aware of their relationship, explain the concept and nature of this relationship and the areas of cooperation and coordination between them.

Thnaibat and Shunnaq Study (2006) entitled "External Auditor's Assessment of the Internal Audit Function in the Light of Implementation of the International Standard on Auditing No. (610): Analytical Study from the Point of View of the External and Internal Auditors in Jordan." The study aims at examining to what extent the external auditor applies the International Standard on Auditing (ISA) No. (610) when considering assessment of an internal audit function from the external and internal auditors' points of view.

The study also examines the differences in the implementation of ISA No. (610) with relation to the differences in personal characteristics of external auditor, and identify the relative importance of the criteria mentioned in ISA No. (610). To achieve the objectives of the study, specially designed questionnaires were distributed to samples of external and internal auditors. Descriptive and nonparametric statistics were used to analyze the data and test the hypotheses. The results of the study indicate that there are significant differences between the external and internal auditors' opinions regarding the extent to which that external auditor applies the ISA No. (610) when assessing the internal audit function.

Abu Ghanem study (2003) entitled "factors affecting the independence of the external auditors in Jordan." It aimed to determine the factors affecting the independence of the external auditor in Jordan, the researcher adopted the descriptive analytical method using a questionnaire distributed to a sample of 138 auditors. Results of the study have shown that the independence of the external auditor in Jordan are affected by a variety of factors such as: Factors related to auditing environment represented in the competition among auditing firms and the personal relationships between the auditor and the client.

Behavioral factors represented in conflict of interests and objectives between the auditor and the client and the method of appointment and isolation of the auditor.

Physical factors represented in the auditor's fees and the evaluation of advisory services. Factors related to the auditing Office represented in the size of the auditing Office and the length of time. Alkhan study (2001) entitled "Ethics and auditors' fees." This study aimed to investigate the rules of professional conduct and the extent of their dealings with topics of remuneration of auditors to limit competition between the members. The researcher has followed the inductive approach in determining the factors affecting the identification of the auditors' fees and reviewing of the rules of professional conduct, so the study concluded the following findings:

There is a strong relationship between the rules of professional conduct and the auditor's fees, as the chapter related to independence has dealt in detail with fees.

There is a continuous update of the rules of professional conduct at the international level, so that the independence of the auditor has been linked to the fees in one chapter. Moreover there was also distinction between the types of auditors and services including services of expressing an emphatic opinion on a particular issue.

## **6. Research Methodology:**

The descriptive analytical method was used through a study to know the extent of the external auditor's reliance on the internal auditor's report in preparing the report on the financial statements on a sample of external auditors by designing a questionnaire and analyzing its questions using the statistical package (SPSS) to help reaching conclusions and recommendations after studying the theoretical aspects of the subject by referring to books, periodicals and previous studies.

Standard deviation: Standard deviation was used to measure the dispersion of the individuals of the study sample from the arithmetic mean, so the lower the standard deviation of the answers the more its homogeneity and closeness to the arithmetic mean.

Coefficient of variation: This coefficient is used to indicate the degree of difference between the responses of the individuals of the study sample, if the coefficient of variation is less than 60%, this will indicate that the agreement of the study sample, but if the coefficient of variation is greater than 60% this will indicate that there is a difference between the study sample answers.

The proportion of influence: used to express the impact of the independent variable on the dependent variable.

One sample t-Test: This test was used to test the hypotheses of the study, which is entitled "The extent of the external auditor's reliance on the internal auditor's report in preparing the report about the financial statements," as it is used to examine whether the arithmetic mean of a variable of the study is equal to a constant value (3).

### **6.1. Research hypotheses:**

Based on the questions that have been presented in the problem of the study, the following hypotheses were formulated:

The external auditor does not depend on the internal auditor's report when giving opinion in the financial statements.

There are no problems facing the external auditor when relying on the internal auditor's report.  
There are no discrepancies in the work of internal and the work of external auditors in writing the report.  
The Internal Auditor does not have any role in facilitating external auditing process.

#### *6.2. Research population:*

Research population is consisted of the external auditors totaling 415 auditors, 250 copies of the questionnaire have been distributed a where the resorted copies was equal to 210 copies, the number of valid copies for analysis estimated 201 copies which is equal to 80% and this ratio is considered to be acceptable.

#### *6.3. The study tool:*

The researcher has designed the questionnaire depending on the study entitled the extent to which the external auditor's relies on the internal auditor's report in preparing the report on the financial statements; the questionnaire consisted of two parts:

##### *6.3.1. Part I:*

Contains personal data related to the respondent to the questionnaire, and this part consists of five questions related to the following:

1. Age
2. Gender
3. Qualification
4. Expertise
5. Job position

##### *6.3.2. Part two:*

Questions 1-10 particularly related to the first hypothesis

Questions 11-15 particularly related to the second hypothesis

Questions 16-21 particularly related to the third hypothesis

Questions 22- 28 particularly related to the fourth hypothesis

#### *6.4. Procedure for treating the questionnaire*

Likert 5-points scale was used to answer the questionnaire as follows:

- Extremely unlikely (one degree)
- unlikely (two degrees)
- Neutral (three degrees)
- likely (four degrees)
- Extremely likely (five degrees)

### **7. Data analysis**

Analysis of Data related to demographical factors of the respondent: the general information used: gender, age, scientific qualification, academic specialty, expertise, job position appearing as follows:

**Table1. Distribution of the individuals of the sample according to demographical factors**

Variable	Variable classes	Number	Percentage
Gender	Male	196	%97.5
	Female	5	%2.5
Age	30 or less	5	%2.5
	40-31	74	%36.8
	41 -50	97	%48.2
	51 or more	25	%12.5
Scientific qualification	Diploma	1	%52.2
	Bachlor	105	%39.8
	Master	80	%7.5
	PhD	15	%89
Expertise	Less than 5 years	18	%9
	From 6 to 10 years	67	%33.3
	From 11 to 15 years	65	%32.3
	From 16 to 20 years	31	%15.4
	More than 20 years	20	%10
Job position	Manager of auditing office	Manager of auditing office	%21
	Major auditor	Major auditor	%59
	Auditor	Auditor	%20

### 7.1. Statistical procedures:

#### 7.1.1. The reliability of the research instrument

Reliability is the consistency of the measurement, or the degree to which an instrument measures the same way each time it is used under the same condition with the same subjects. Internal consistency estimates reliability by grouping questions in a questionnaire that measure the same concept. One common way of computing correlation values among the questions on your instruments is by using Cronbach's Alpha. The statistically acceptable value of Cronbach's Alpha in humanities studies is 60% or more. Table (2) illustrates the reliability coefficients.

**Table 2.**Reliability coefficients

Study variables	Cronbach's Alpha
The extent to which the external auditor relies on the report of the internal auditor when preparing the financial statements	82.32%
The problems that face the external auditor when relying on the internal auditor	75.33%
The difference aspects in the works of the external auditor and the internal auditor in writing the report	77.3%
The role of the internal auditor in facilitating the work of the external auditor	90.7%
The total indicator of the questionnaire	88.2%

#### 7.1.2. Results and hypotheses testing

Hypothesis 1: The external auditor does not depend on the internal auditor's report when giving opinion in the financial statements.

This hypothesis has been tested depending on questions (1-10). Table (3) illustrates descriptive statistics of the opinions of the respondents about the extent of the external auditor's reliance on the internal auditor's report when preparing the report about the financial statements.

**Table 3.** Descriptive statistics of the opinions of the respondents about the extent of the external auditor's reliance on the internal auditor's report when preparing the report about the financial statements

Item No	Question	Arithmetic mean	Standard deviation	Variation coefficient %
1	It is the responsibility of the external auditor designing the audit plan, procedures to detect manipulation and fraud in the financial statements tests which affects the external report	4.5		33
2	The responsibility of the internal auditor give an opinion to senior management, which affects the external report	4.8		40
3	Internal Audit an independent, objective and consultative process aimed at raising the value and improve of any organizational work which affects the external report	3.2		37
4	Internal audit for the management ensures analysis assessments and recommendations, advice and information on a regular basis. And seeks to ensure effective control of cost and identify ways to improve the degree of efficiency and savings and rationalization in the internal procedures which affects the external report	3.2		37
5	Internal Auditor prepares the internal audit in a professional and neutral manner without bias. conflict of interest should be avoided which affects the external report	4.5		33
6	Internal Auditor will be on standby to receive complaints or information from individual staff directly with respect to the possibility of the existence of cases of fraud, waste, abuse of power or fails to comply with the WIPO systems and regulations in the affairs of management and staff which affects the external report	4.1		37
7	The draft audit report submitted to the supervisor in charge and direct the program or activity under scrutiny, and given an opportunity to respond within the time limit specified in the report, which affects the external report	3.8		47
8	Director-General ensures the right of all employees in a secret communication with the internal auditor and provide him with information	3.7		37
9	Director-General ensures the comprehensiveness of reports on internal audit and investigations, inspections, and respect for the time and care to objectivity and accuracy which affects the external report	3.2		37
10	At the end of each audit, an audit report is issued on the audit shows the objectives, scope, methodology, findings and goals thus affecting the external report	4.5		33
	The questions as a whole	3.8		42

We note from Table (3) that there is a relationship to a great extent where the arithmetic mean of the questions has reached 3.8 which is higher than the average of the measurement instrument (3), also the percentage of the impact of the questions was (87) which is higher than the approved percentage in this study (60%). The standard deviation for questions combined was 1.9, and the variation coefficient reached (42%) which is less than the approved rate in this study, 60%, and this shows the good harmony to some extent between the responses of respondents.

First hypothesis test using (one sample t-test),

**Table4.** The results of the test are :

The result of the null Hypothesis	Sig. (t)	Tabulated (t)	Calculated (t)
Reject	0.01	2.11	19.352

We note from Table (4) that the value of (T calculated = 19.352) which is larger than its tabulated value, so we reject the null hypothesis and accept the alternative hypothesis, which means: the external auditor depends on the internal auditor's report when preparing the report about the financial statements.

The second hypothesis: There are no problems facing the external auditor when relying on the internal auditor's report.

This hypothesis has been tested depending on the questions 11-15 of the questionnaire; Table (5) illustrates the descriptive statistics for the views of the sample and the presence of problems facing the external auditor when relying on the internal auditor's report.

**Table 5.**The descriptive statistics for the views of the sample and the presence of problems facing the external auditor when relying on the internal auditor's report

Item No	Question	Arithmetic mean	Standard deviation	Variation coefficient %
11	The auditor must take into account the possibility of management override of internal control systems	1.6		38
12	The auditor must ensure that the assigned to control have sufficient expertise to detect fraud and manipulation	3.8		34
13	The auditor must obtain the inquiries of management with respect to its methods of follow-up assigned to control.	4		37
14	It is the responsibility of the auditor to ensure appropriateness of accounting principles and policies applied by management in the preparation of financial statements.	4.2		33
15	the external auditor should ensure the independence of the internal auditor	4		34
16	The questions as a whole	4.3		37

Table (5) indicates that there are problems. The arithmetic mean was 4.1, which is higher than the average of the measurement (3) also the percentage of the impact of the questions combined reached 76%, which is higher than the approved percentage in this study (60%) The standard deviation of questions combined was (2.9) and the coefficient of variation of the questions combined reached (37) which is less than the approved rate in this study (60%) and this shows that there is a lack in variance in the answers respondents The hypothesis was tested using (one sample t-test) and the results were as follows in Table 6:

**Table 6:** The second hypothesis test results

The result of the null Hypothesis	Sig. (t)	Tabulated (t)	Calculated (t)
Reject	0.02	10.343	24.234

We note from Table (6) that the value of (T calculated = 24.234) is less than its tabulated value, therefore we reject the null hypothesis and accept the alternative hypothesis, which means: There are problems facing the external auditor when relying on the internal auditor's report.

The third hypothesis: There are no discrepancies in the work of internal and the work of external auditors in writing the report.

This hypothesis has been tested depending on the questions (16-21). Table (7) illustrates the descriptive statistics for the views of the sample whether there are similarities in the work of internal and external auditors in writing the report.

**Table 7.**Whether there are similarities in the work of internal and external auditors in writing the report

Item No	Question	Arithmetic mean	Standard deviation	Variation coefficient %
	The auditor is assisted by the internal auditor and the Audit Committee to make sure that there are no acts of manipulation and fraud.	2.8	21.8	74
	The external auditor's report depends on the report of the internal auditor	3.6	2.1	37.1
	The external auditor's report is affected by the report of the internal auditor	4.8	1.1	40
	The external auditor's report strengthens the internal auditor's report	3.2	1.7	37
	The external auditor's report differs from the report of the internal auditor in form	4.5	1.1	33
	The external auditor's report differs from the report of the internal auditor content	4.1	1.8	37
	The questions as a whole	3.9	1.8	43

We note from Table (7) that there are variations to a large extent, where the arithmetic mean of the questions was 3.9 which is higher than the average of measurement tool (3). Also the percentage of the impact of the questions combined reached (88) which is higher than the approved percentage in this study (60%) and standard deviation of questions combined reached 1.8, and the coefficient of variation reached (43%) which is less than the approved rate in this study, 60%, and this shows the good harmony to some extent between the responses of respondents.

The third hypothesis test (one sample t-test),

**Table 8.** The results of the test :

The result of the null Hypothesis	Sig. (t)	Tabulated (t)	Calculated (t)
Reject	0.00	2.10	18.252

We note from the table (8), the value of (T calculated = 18.252) which is higher than its tabulated value, so we reject the null hypothesis and accept the alternative hypothesis, which means: There are variations in the work of internal and external auditors in writing the report. The fourth hypothesis: The Internal Auditor does not have any role in facilitating external auditing process. This hypothesis has been tested depending on the questions (22-28). Table (9) illustrates the descriptive statistics for the views of the sample.

**Table 9.**The descriptive statistics for the views of the sample

Item No	Question	Arithmetic mean	Standard deviation	Variation coefficient %
22	Through continuous monitoring processes and decisions	3.7	1.8	48
23	Continuous improvement activities of operations and decisions	3.8	1.6	34
24	Treatment of deficit of mechanisms of report preparation	4	1.3	37
25	Corrective action of control on operations	4.2	1.1	33
26	By examining the settlement process	4	1.3	24
27	Timely to display data	3.7	1.8	48
28	The accuracy of the data displayed	3.8	1.6	34
39	1.9	4.1		

Table (9) indicates that there is a role of the internal auditor in facilitating the external audit process, with an arithmetic mean of 4.1 which is higher than the average of measurement 3 also the percentage of the impact of the questions combined was (79%) which is higher than the approved percentage in this study (60) %, also the standard deviation of questions combined was (1.9) and the coefficient of variation of the questions combined reached (39) which is less than the approved percentage in this study (60%) and this shows a lack of variance between the answers of the respondents.

The hypothesis was tested using (one sample t-test) and the results were as follows in the table (10)

**Table 10.** Fourth hypothesis test results

The result of the null Hypothesis	Sig. (t)	Tabulated (t)	Calculated (t)
Reject	0.01	1.111	24.57

We note from Table No. (10) that the value of the ((T calculated = 25.57 is greater than its tabulated value, and therefore we reject the null hypothesis and accept the alternative hypothesis, which means: There is a role of the Internal Auditor in facilitating external audit process.

### 8. Results:

The external auditor relies on the internal auditor's report in preparing the report on the financial statements, the hypothesis got the fourth rank where the arithmetic average equals 3.8 and sig is 0.01.

There are problems facing the external auditor when relies on the internal auditor's report in preparing the report on the financial statements, and the hypothesis got the first rank where the mean was 4.3 and the value of sig is 0.02

There are variations in the work of internal and external auditors when writing the report about the financial statements, and the hypothesis got the third rank where the mean was 3.9 and the value of sig is 0.00

There is the role of the Internal Auditor in facilitating the external audit process, and the hypothesis got the second place where the mean was 4.1 and the value of sig was 0.01

### 9. Recommendations:

The external auditor should ensure the integrity and transparency of the internal auditor when relying on the internal auditor's report.

The external auditor should make sure that the internal auditor taking into account the internal audit standards when preparing his report.



The external auditor should take into account the nature of the differences in the work of the internal auditor in the preparation of his report.

The external auditor should activate the channels of the internal auditor in order to benefit from his work to facilitate the work of the external auditor.

Work on the establishment of courses and training programs that lead to increased efficiency and positive performance and the Internal Auditor, which helps in the development of reports submitted to contribute positively in the external audit process.

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