

# Anatomy of Audit Opinion beyond Economic Reform: Evidence from Jordan

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**Abstract** The study is an attempt to explore factors related to economic reform that affect the content and the form of audit report in Jordan. Auditing environment in Jordan has been affected by many factors such as economic reform during the end of 90's and the beginning of the last decade. This effect imposed Jordan to adopt the International Financial Reporting Standards (IFRS). On other hand, the study examines the audit opinion issued by Jordanian companies listed in Amman Stock Exchange (ASE) during the period 2006-2011. In particular, the study extensively focuses on the type of the issued reports and on many aspects stated in the auditing reports regarding the proceeding factors. Findings showed that the audit's reports had substantial changes due to the economic reform applied in Jordan.

**Keywords:** Audit Report, Emphasis of Matter, Jordan, Economic reform, Audit Environment

## 1. Introduction

Countries world-wide have pursued the same goals when coming to the welfare of their economy which is considered a part of the increasingly dynamic global market. This is the aim which is mainly pursued by developing countries more than any other countries. Globalization has played a key role in this by dissolving the boundaries between countries and financial markets. The increase in multinational companies' activities, economic co-operations and political unifications between developed countries increases the efforts of the developing countries to be a part of this global market which, in return, requires transparent financial information (Alp & Ustang, 2009). Economic and political factors have contributed to the "sudden rush" of the international communities to converge their national generally accepted accounting principles (GAAP) with IFRS (Fontes et al., 2005, p.416).

Domestic economies have become increasingly vulnerable to the "external shocks" caused by an "expanding world economy", necessitating the adoption of globalized practices if they function effectively (Lehman, 2005, p.979). Globalization is defined as: "a worldwide pressure to change", as the "closer integration of the countries and the people in the world" (Stiglitz, 2001, p.9). Since the beginning of 2005, it has been necessary for all entities whose headquarters are within EU borders and are registered in the stock exchange to apply to IFRS (Yalkin et al., 2008). Currently, over 120 countries and reporting jurisdictions require or allow the use of IFRS for preparation of financial statements for domestic listed companies (AICPA, 2013).

Jordan has adopted the full version of the IAS/IFRS without any modifications. Adoption of IFRS was part of legal and regulations environment reform. It was incorporated in the Jordanian Company Law 22/1997 and the Securities Commission Law 23/1997 (Al-Akra et al., 2009). Some aspects of the Jordanian environment made it slightly difficult to achieve the complete compliance with the IASB standards. This is not a problem facing only Jordan but other Middle-Eastern countries as well. There is a current view promoted by international bodies such as the World Trade Organization (WTO), Organization for Economic Development (OECD), the International Monetary Fund (IMF) and the World Bank (WB) that: "measurement and reporting problems faced by accountants are the same throughout the world, but it may be naive at the same time to presume that it is reasonable to have one single regulatory framework for "all financial reporting needs of all societies" (Rodrigues & Craig, 2007, p. 745) Jordan's official language is Arabic, and all accounting regulations and financial reporting are in Arabic along with the personal choice of some companies to report in both languages: Arabic and English. Thus the Arabic language faces

little difficulty in the translation of technical accounting terms, such as (1) The use of lengthy English sentences, (2) The use of terminology inconsistently, (3) Using the same terminology to describe different concepts, (4) The use of some terms which are very difficult to interpret and translate. But there are noticeable efforts from some countries such as Egypt which has developed a uniform accounting system in Arabic that helped Arab countries (Al-Omari & Salimi, 2000).

## 2. Nature, scope and objectives of audit report:

Auditor's report is a tool of communication between the auditors and the interested parties; therefore, the preparation of the report is one of the first duties of the auditor who must submit the report to shareholders and other interested parties. As required by article 193, paragraph (g) of the Jordanian Companies Act No. 22 of 1997, the auditor must submit a written report to the shareholders and relevant parties (Al-matarneh, 2011). It means that the auditor's report should contain the audit neutral opinion; the auditor must report his/her opinion to the General Assembly of shareholders. Thus, external auditing is considered as a well-organized process to get evidences that help the auditor to give his neutral opinion. The auditor is responsible for reviewing whether financial statements, which are the company's management responsibility, are prepared in accordance with the standards, the legislations, the regulations, and the requirements (Alkhatib & Marji, 2012). The information, which should be audited by an independent auditor, should include a statement of financial position, income statement, statement of cash flow, statement of changes in shareholder equity, notes to financial statements and board of directors' declarations.

International Auditing Standard IAS 700/A/1 (International Auditing and Assurance Standards Board (IAASB), 2012) at IAS 700/7/C provides definition to the audit report which is prepared by the auditor at the completion of the audit process where "the auditor expressed unmodified opinion when the auditor concludes that the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework".

The Jordanian Companies' Law 22/1997 requires public shareholding companies, general partnerships, limited partnerships, limited liability companies, private shareholding companies, and foreign companies operating in Jordan to prepare annual audited financial statements. Furthermore, the Jordanian Companies' Law 22/1997 /article (195/a) requires all companies registered under the Companies Law to maintain organized accounting records and documents and present audited financial statements in accordance with 'internationally recognized accounting and auditing principles. It states whether auditors have been given access to all information and assistance in order to conduct audits. According to the Jordanian Securities Commission (JSC) Law (23/1997) and Directives of Disclosures, Auditing, and Accounting Standards (1/1998), all companies which are subjected to JSC's supervision are also required to apply the International Financial Reporting Standards (IFRS).

In Jordan, audit opinion types are similar to those in Western countries. There are two main categories of opinions: Unmodified (unqualified) and modified audit opinions. Modified audit opinion is divided into four subtypes: unqualified with an explanatory paragraph, unqualified with an emphasis of matter (EOM), Qualified, and adverse or disclaimer opinion. Following this classification, according to the Companies Law 22/1997 /article (195/b), the auditor provides an opinion on the company's financial statements by one of the following ways: Absolute approval (unmodified /unqualified opinion), approval with reserve (modified / qualified opinion) but the auditor must provide that he states the reasons for such a reservation and its financial effect on the company, and non-approval (adverse or disclaimer opinion), the auditor must return the financial statements to the company's Board of Directors with the reasons of justifying the rejection.

### 2.1. Unmodified (unqualified) opinion

The auditor shall express an unmodified (unqualified) opinion when the auditor concludes that the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework. The auditor expresses his/her opinion on the basis of examination and the evidence collected that financial statements of the entity are prepared in all material respects in accordance with applicable financial reporting framework or financial statements provide reasonable assurance that are free from errors, fraud and misstatement. ISA 700 describes the content and format of the unmodified report in details.

## 2.2. Modified opinion

In some circumstances, the auditor's report content may be modified as stated in ISA 700. Modification of report may be done either by adding an emphasis of matter (EOM) paragraph or other matters paragraph while the auditor's opinion is still unmodified (unqualified), or by modifying the opinion, in this case the auditor changes his/her opinion to qualified or adverse, or disclaimer opinion. International Auditing and Assurance Standard Board (IAASB, 2009) asserts that in some circumstances auditor needs to modify the opinion in the audit report. These circumstances are: the auditor is not able to obtain sufficient and appropriate evidence about the going concern, the information included in the financial statements in relation to going concern is not correct or persuasive, and the auditor disagrees with the use of going concern basis in the preparation of financial statement that is used by the entity's management.

### 2.2.3. Inclusion going concern assumption in EOM paragraph.

The audit report with emphasis of matter paragraph (EOM) issues may be when auditor considers that he/her should draw the attention to users of financial statements that matter disclosed or presented by the entity's management is significantly affected the understanding of the financial statements' content. As International Auditing and Assurance Standard Board (IAASB, 2009) provides key message about the appropriateness of the use going concern assumption in which the auditor has to consider conducting audit process. Taking this assumption into account, consideration of the need for an EOM paragraph in the auditor's report, for example, the credit's crises and economic downturn may affect an entity's ability to continue as going concern. International Standard on Auditing 570 (ISA, 2009) regarding to going concern sets relevant requirements and guidance with regard to the auditor's considerations of the appropriate management's use of going concern assumption when preparing its financial statements and inclusion of going concern assumption in auditor's report.

In Jordan, before 2006 audit reports did not have separated paragraphs which define the management's responsibility, auditor's responsibility and opinion of the auditors. In 2006, it was the first time when auditing firms separated the basic paragraphs in auditing reports.

Since the accounting standards are the guidance for the preparation of the financial reports, which reflect the financial image of these publishing corporations, the economy, or even the society as a whole will be affected by applying different sets of standards and policies. The auditing report lends credibility to the directors' financial reports by validating the techniques of financial measurements and reports adopted by them (Xu, et al., 2011). The primary objective in this research is to evaluate the change in the auditing reports within the period from 2006 to 2011 in the public shareholding companies in Jordan. This period has been chosen because it is the post-privatization period. Many companies have been privatized and are subjected to apply the IFRS and International Auditing Standards (Cheffers et al., 2011).

## 3. Research Methodology

### 3.1. Research problem

The problem for this research is stemmed from the importance of auditing reports (external audit) in the process of decision making in shareholding companies in Jordan. In addition, it is critical for the shareholders because the auditor plays the role of an advocate who works in their behalf. So the study tries to make a comparison between the audit's reports of the shareholding companies listed in Jordan Securities Commission and to highlight the changes in the auditor's report during the period 2006-2011.

This paper seeks to examine how the changes in auditing environment due to the economic reform affect the direction and magnitude of audit's opinion. The study contributes to the literature in three phases: First, it examines the nature of the audit's opinion's modification considering whether different types of opinions (i.e., qualified opinions as compared to disclaimers). Second, it examines the change in audit's opinion rather than the nature of the opinion in the current year. Finally, it examines the content of audits' opinions upon the Jordanian context which has undergone a number of changes in terms of the legal and economic environment.

### 3.2. Data collection

Trying to figure out a solution of the research's problems, this study examines the period 2006–2011. Financial reports reflect changes in the economic conditions with a lag sample period ends in December 2011 due to the availability of data at the time of writing. All of the data of this study were obtained from Amman Stock Exchange Website. The researcher collected the audit's reports for 202 Jordanian public companies representing approximately 84% of companies listed in Amman Stock Exchange for the period 2006–2011. Attempting to gather the reports in a sequenced matter of the companies of the sample but there are always missing years, so the number of auditors' reports in the study ranged from 190 in 2011 to 214 in 2010. Under IAS 705, audit reports are classified as unqualified, unqualified with an emphasis of matter, qualified going concern. Each EOM is then categorised into one of the categories available under ISA 706, significant uncertainty regarding ability to continue as a going concern; significant uncertainty for reasons other than going concern; additional disclosure with which the auditor concurs; inconsistent other information; or a subsequent event which creates new conditions or a revised financial report. Moreover, this classification is consistent with the coding pattern applied by Carson et al. (2006) and Xu et al. (2011).

**Table 1. Number of Companies in the sample**

Sector	Study population	Sample	Percent %
Banks	15	15	7%
Insurance	27	26	12%
Diversified Financial services	36	27	13%
real states	35	32	15%
Services	57	51	24%
Industry	71	63	29%
Total	241	214	100%

The data were collected from the website of Amman Stock Exchange (ASE). According to ASE, the equities consist of three sectors: financial, services and industrial. The financial sectors consist of banks, insurance, diversified financial services and real states' companies. As shown in table 1 the total number of the shareholding companies in the various sectors, in this research, is 214 companies which compose in percentage 85% from the total companies. The industrial sector represented the highest percentage (29%) while the banks' sector represented the lowest percentage (7%) although all of the Jordanian banks are involved in the study. The total of audit's reports collected during the period of study was 1212.

#### 4. Findings and discussion

**Table 2. Type of Audit Opinion during 2006-2011**

	UNQ		UNQWEOM		QUFGC		QUWEOM		QUO		AD or Dis		Total	
	NO	%	NO	%	NO	%	NO	%	NO	%	NO	%	NO	%
2006	145	0.75	22	0.11	6	0.03	8	0.04	12	0.06	0	0	193	1
2007	143	0.73	25	0.13	7	0.04	7	0.04	14	0.07	0	0	196	1
2008	142	0.69	26	0.13	11	0.05	12	0.06	16	0.08	0	0	207	1
2009	134	0.63	31	0.15	12	0.06	13	0.06	22	0.1	0	0	212	1
2010	131	0.61	39	0.18	9	0.04	9	0.04	26	0.12	0	0	214	1
2011	121	0.64	44	0.23	7	0.04	6	0.03	12	0.06	0	0	190	1
Total	816	0.67	187	0.15	52	0.04	55	0.05	102	0.08	0	0	1212	1

Table 2 shows the types of audit's opinion issued by Jordanian auditors for the period 2006–2011. From table 2, it can be seen that the majority of the listed companies received an unqualified audit opinion (unmodified opinion). About 816 reports in number and 67% of the opinions issued over the sample period were unqualified. The percentage of unqualified (UNQ) reports was declined from year to year; they reached 75% in the year 2006 then they declined gradually to reach 61% in the year 2010, then started to get up during the year 2011. This significant

change is due to the economic process that took place in 2005. As stated previously, the economic reforms affected the auditing environment by adopting several professional legislations such as issuing new accounting professional law 2004 which emphasised on fully adoption of IFRS and International Auditing Standards. The unqualified opinions with EOM (UNQWEOM) are 187 reports with 15%. From table 2, the UNQWEOM reports to some extent increased during the period of study. This slight growth is also due to the economic reform which was imposed to apply the international standards (IFRS and IAS). Thus, the decrease in unqualified opinion's reports is mainly attributed to the increase in unqualified reports with EOM with 0.11% in 2006 to reach 0.23% in 2010. Figuring the unmodified opinion (UNQ and UNQWEOM) are reached 1003 reports, 83% during the period of study.

The number of qualified opinion's reports (except for) in the three categories, qualified opinion for going (QUFGO) concern, with emphasis of matter (QUWEOM) and qualified other (QUO) to some extent is relatively constant, from 0.13% in 2006, to 0.22% in 2009.

From table 2 it is noticeable that the Jordanian auditors did not issue adverse or disclaimer reports during the period of the study 2006-2011. This result due to several factors such as: shareholding companies listed in Amman Stock Exchange have to apply the corporate governance code and at oversight of some governmental regulatory agencies such as Jordanian Securities Commission and Companies Controlling Department. An auditor also commented on this result.

"In Jordan, I can say you will not find auditor issue adverse or disclaimer opinion especially the shareholding company trading in Amman Stock Exchange. I think the reason behind this is these companies are controlled by many governmental institutions, for example the banks are subjected to oversight by Central Bank of Jordan, Jordanian Securities Commission and Ministry of Industry and Trading. I think you may find many adverse audit opinion if you conduct your study on medium or small enterprise".

**Table 3. Type of Audit Report Regarding EOM Categories**

EOM Categories	2006		2007		2008		2009		2011		Total	
	NO	%	NO	NO	NO	NO	NO	%	NO	%	NO	%
matter or disclosure that is	0	0	0	0	1	0	0	0	1	0.04%		
Subsequent events have :	1	3%	0	0	0	1	2%	3	1%			
material uncertainty exist :	22	73%	26	31	38	41	82%	200	83%			
significant uncertainty sui	6	20%	6	7	5	8	16%	37	15.50%			
inconsistent information v	0	0	0	0	0	0	0	0	0			
Total	30	12%	32	38	44	50	21%	242	100%			

\*This table contains two types of audit reports, UQWEOM and QUWEOM

Table 3 classifies the EOMs included by auditors in their audit opinions into the categories outlined in SA 706. These categories are matter or disclosure in the financial statements that is important to the users' understanding; Subsequent events that have significant impact, material uncertainty exist surrounding the use of going concern assumption, significant uncertainty surrounding accounting estimate and inconsistent information with audited financial report. From this table it can be noted that more than 80% of the EOMs relate to issues of going concern. It is obvious that during the period 2006-2011, the number of going concern related to EOMs increased gradually from 22 to 26 in the years (2006-2007), 31 in (2008), 38 in (2009), 42 in 2010 and 41 in 2011.

The majority of EOM's paragraphs revolves around that there is substantial doubt about an entity's ability to continue as a going concern. The majority of opinions refer to issues such as working capital deficiencies, substantial losses or negative operating cash flows, noncompliance with statutory capital requirements, deferred payments to creditors, uncertainty relating to a pending unusually important litigation matter such as taxation issues and limitations to the ability to obtain further financing.

The study finds few incidences of EOMs for reasons other than significant uncertainty about the ability to going concern such as: (a) failure to regulate goods in the warehouse and to regulate the procedure of inventorying easily, (b) companies did not calculate the depreciation of the equipment and properties on the basis of directing council's decisions which led to the reduction of losses and increase in net equity, and (c) the accompanying financial statements reflect the financial statements of the parent company only without standardization of the financial statements of the subsidiaries with it which is contrary to IFRS.

Considering tables 2 and 3, there is no significant evidence that the economic reform in Jordan, in terms of reforming the legal audit environment, was associated with an increase in modification of audit report's opinion. But there is a

noticeable modification with respect to inclusion issues influencing the entities' ability as a going concern. The GFC does not have a significant effect in the audit's report in Jordan.

**Table 4. Type of Audit Opinion by Sector**

	UNQ	UNQWEOM	QUFGC	QUWEOM	QUO	Total	Total modified		
Banks	90	0	0	0	0	90	7.40%	0	0
Insurance	80	26	8	10	8	132	10.90%	52	13%
Financial services	101	38	6	6	11	162	13.40%	61	15%
real states	106	26	12	11	13	168	13.90%	62	16%
Services	206	44	10	15	19	294	24.30%	88	22%
Industry	233	53	16	13	51	366	30.20%	133	34%
Total	816	187	52	55	102	1212	100%	396	33%

Table 4 shows the classification of audit's opinion among industries. It is expected that modifications of audit report are varied according to the nature of business. The modifications consist of UNQWEOM, QUFGC, QUWEOM and QUO. The industry is grouped into five categories which are used by Amman Stock Exchange. The industries with the highest modification rate are industry (manufacturing) sector 34% and service sector 22%. Also, the other sectors as insurance, financial services and real state showed significant change in audit opinion with 13%, 15% and 16% respectively. But the most serious and surprised result is that there is no modification rate in the banks' sector during the period of study and this result may due to sever control by many governmental agencies such as Central Bank of Jordan. Consequently, banks' management is aware precisely to apply the rules which governed the corporations.

**Table 5. Type of Audit Opinion by Audit Firm**

	Modified opinions					TOTAL	Total Modified			
	UNQ	UNQWEOM	QUFGC	QUWEOM	QUO					
Earnst& Young	94	30	10	10	25	169	13.90%	75	19%	
Deloitte & Touch	88	25	9	10	22	154	12.70%	66	16%	
KPMG	54	14	5	8	5	86	7.10%	32	8%	
PWC	56	8	2	0	0	66	5.40%	10	3%	
Arab Professionals	91	22	7	10	18	148	12.20%	57	14%	
Talal Abu Ghazala	84	32	7	8	22	153	12.60%	69	17%	
Abbasi	84	15	3	3	8	113	9.30%	29	7%	
Dweik	72	10	2	0	2	86	7.10%	14	4%	
BDO	54	8	2	0	0	64	5.30%	10	3%	
Ghosheh	74	12	5	6	0	97	8%	23	6%	
Others	65	11	0	0	0	76	6.30%	11	3%	
Total	816 (67%)	187	52	55	102	1212	100%	396	33%	

Table 5 indicates the type of audit reports issued by audit firms. From the table, it is noted that the majority of the audit opinions issued by audit firms during the period 2006-2011 is unmodified 816, with percentage 67%, while the unmodified opinions reached 396 reports with percentage 33% of all reports. This is a significant change in audit's opinion. The largest number of issuing modified opinions is unqualified with EOM 187 reports with percentage 47% of all modified reports. The modified opinions for the Big Four auditors (Earnst& Young, Deloitte& Touch, KPMG and PWC) differ significantly ranging from 19% for Earnst& Young, 16% for Deloitte & Touch, 8% for KPMG to 3% for PWC which is the lowest percentage. Whereas, the modified opinions for the non-Big Four auditors differ significantly ranging from 17% for Talal Abu Ghazala to 3% for BDO. Among the Big Four and no-Big Four, Earnst & Young appears to have high rate in number and percentage for both unmodified (UNQ) and modified opinion (94,12%), (75, 19%) respectively. Among the no-Big Four, Arab Professionals appear to have high rate in unmodified (UNQ) opinion (91, 11%), while Talal Abu Ghazala appears to have high rate in modified opinion (69,17%).

These findings support the impact of economic reform in Jordan particularly in audit environment. There are differences between Big Four and non-Big four in terms of issuing a modification report. The researcher would like to note that the differences in audit clients have not been addressed in the study and this may due to the differences in the nature and the size of audit's clients. The clients of non-Big four may be smaller and riskier than those of Big Four.

## 5. Conclusion

Since Jordan has applied the economic reform, the audit's environment improved and upgraded. Adoption of the IFRS and IAS make auditors aware of releasing their audit's opinion. This shows that the changes in audit environment have had a significant and the desired effect of improving the disclosure in the financial statements, with which the auditor must concur, rather than resulting in an audit qualification. Auditors who are satisfied with the level of disclosure can issue an unqualified report, and they can attract the users' attention to these issues by issuing reports with EOM. As a result, EOM paragraphs have become quite common and 33% of the report was issued during 2006 -2011. In particular, it is obvious that during this period, going concern modifications have increased substantially. Unmodified audit opinions (UNQ) decreased slightly during the period of the study 2006-2011. In contrast, the modified opinions (UNQWOM, QU, QUWEOM, QUFG, and QUO) increased fairly during the same period. Finally, the most serious forms of qualification are the adverse opinion and disclaimer of opinion which are never used by Jordanian auditors during the period 2006- 2011. The sample of the study which consisted of 214 companies represented 85% of the listed companies in ASE.

In Jordan, this paper is the first study examines the various types of EOMs given. The results show that during the period 2006–2011, there are no observations identified for two of the five EOM categories (accompanying information is inconsistent with the audited financial report, and subsequent events result in a new audit report on a revised financial report) and few for two other categories (additional disclosure with which the auditor concurs, and subsequent event creates new conditions which did not exist at reporting date. Majority of all the EOMs relate to one category (material uncertainty exists surrounding the use of going concern assumption) is adequately disclosed. Also, the growth in EOMs in this category was noticeable; about 200 opinions of 242 in overall with percentage reached 83%. In addition, majority of EOM opinions refer to issues such as working capital deficiencies, substantial losses or negative operating cash flows, noncompliance with statutory capital requirements, deferred payments to creditors, uncertainty relating to a pending unusually important litigation matter such as taxation issues and limitations on the ability to obtain further financing.

Significant differences are observed in the rate of unmodified and modified issued by the various audit's firms. Majority of the audit's opinions issued by audit firms during the period 2006-2011 are unmodified 816, with percentage 67%, while the unmodified opinions are 396 reports with percentage 33% of all reports. The largest number of issuing modified opinions is unqualified with EOM 187 reports with percentage 47% of all modified reports. The modified opinions for the Big Four auditors differ significantly; they range from 19% for Earnst& Young to 3% for PWC which is the lowest percentage. Whereas, the modified opinion for the non-Big Four auditors differs significantly ranging from 17% for Talal Abu Ghazala to 3% for BDO. Among the Big Four and no- Big Four, Earnst& Young has the highest rate for both unmodified (UNQ) and modified opinion (94,12%), (75, 19%) respectively. Among the no- Big Four, Arab Professionals have high rate in unmodified (UNQ) opinion (91, 11%), while Talal Abu Ghazala has a high rate in modified opinion (69,17%). This result may due to the differences in the nature and the size of audit's clients. The clients of non-Big four may be smaller and riskier than those of Big Four.

In addition, significant differences are found in the rate of modified audit's reports issued by different industry's sectors. In particular, the modification rate is the highest for the industry and service sectors. Other sectors also showed significant change in audit's opinion. But the most serious and surprised result that there is no modification rate in the banks' sector during the period of study and this result may due to strict control by many governmental agencies.

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