Auditors’ Opinion: The Paradox of “True and Fair View” of Financial Statements

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Abstract—The appropriateness of the age-old accounting phrase “true and fair view” has been questioned in recent times. This stems from the irreconcilable corporate failures of entities whose financial statements had been earlier adjudged, by audit opinion, as being “true and fair”. In the light of the increasing doubts about the truism of financial statements, the objective of this study is to examine how true and fair financial statements are, and propose an alternative concept for use in expressing audit opinion on financial statements. The desk-based approach supplemented with information from some accounting practitioners, is used and the method of analysis is explanatory in nature. The issues highlighted in the discourse on the “true and fair view” concept corroborate the opinion of previous empirical studies that it is virtually and currently unrealistic to describe financial statements as being “true”. It is thus recommended that the phrase should rather be “that the financial statements present fairly the state of the affairs of the organization”.

Index Terms—Audit; Auditor; Auditor’s Opinion; Financial Statements.

I. INTRODUCTION

The need to provide reliable, dependable, accurate and realistic information to decision makers cannot be over emphasized. This is because the amount, quality and accuracy of information available to decision makers shape the direction and focus of the business operation. Business stakeholders and other interested parties require an array of information for investment, purchase, evaluation, expansion and take-over decisions. These decisions are normally based on the information available to the decision makers. Any decision made without accurate information often result in failure, this is a wakeup call for preparers of financial statements to provide information that contain the basic features required by decision makers.

In the recent past, cases of corporate failures and collapse abound in the world such as Enron in 2001, Nicor in 2002, Halliburton in 2002, Nortel in 2003 and the collapse of banks in Nigeria in 2006 and 2008. The causes of these failures are traced to the magnitude and the quality of information provided by the management and auditors of these failed establishments. Since decision makers placed absolute reliance on the information contained in the financial statements (annual report) as being true, reliable, accurate, comprehensive and dependable. These scenarios raised a significant question: how “true and fair” are financial statements prepared, reviewed, audited and attested to by management and independent auditors are [14].

The development in the business world in recent times has elicited a serious concern and opens a vista of debate on these terms – “true and fair view”. Thus, the need to evaluate these concepts that have been in use in the accounting and auditing profession over centuries is of utmost importance. The paper is aimed at examining how true and fair financial statements are and propose an alternative concept for use in order to accommodate activities that are subsumed in the financial statements [11].

II. LITERATURE REVIEW

This section is subdivided into three parts namely: the conceptual review, theoretical framework and review of empirical studies.

A. Conceptual Review

AUDITING FEATURES AND IMPORTANCE

According to [1], audit is an independent review of the accuracy of a company’s or governments financial records by the external auditors with a view to determining whether or not an organization is providing a fair and accurate representation of its financial position. This audit is statutory in line with Companies and Allied Matters Act (CAMA) 1990 as amended. The principal objective of the statutory audit is to ensure that the financial statements – statement of financial position, statement of profit or loss account give a true and fair view, and are free from any material misstatement.

Auditing is also referred to as the examination of records and other documents to obtain and assess underlying evidence from which financial statements have been prepared with a view to enabling the independent person to report whether in his opinion the financial statements have been properly drawn up and gives a true and fair view of the state of affairs of the entity [10].

Auditing possess certain characteristics uniquely identified, these include:

1) It brings about weaknesses in the system of accounting and internal control and by such weakness could be eliminated.
2) Ascertainment, recording and evaluation of the system’s accounting and internal control of the client i.e. Organization.
3) Tests and enquiries including the verification of assets and liabilities in order to form an opinion on the reliability of the records as a basis for the preparation of the
accounts.
4) General review of the financial statements including the application of analytical review procedures.
5) Reporting to the client whether the account presented shows a true and fair view of the state of affairs of the entity.
6) The overriding features of independent auditing include accountability, integrity, objectivity and independence, competence, vigor, judgment, clear communication, attestation and monthly value – reliability and quality of financial reporting [11].

Auditing is crucial and important to the business stakeholders. The stakeholders insist on auditing for the following reasons:
1) It prevents disagreement between parties in the case of introduction of new parties or partnership dissolution.
2) Audited accounts are useful for negotiating bank loans and overdraft facilities.
3) Audited accounts serve as a basis for business valuations, mergers and acquisition.
4) It facilitates agreement of assessable income and tax assessment.
5) It gives prospective investors guidance on investment decisions.
6) Errors, fraud and other irregularities are likely to be detected quickly through an audit exercise.
7) It serves as a deterrent and check against frauds and other irregularities [15].

AUDITOR’S OPINION AND TYPES
An auditor’s opinion is a formal statement made by an auditor concerning a client’s financial statement. The end of all audit exercise result is issuance of report and expression of opinion on the status of the financial statements. An opinion is a certification that accompanies financial statements based on an audit of accountant’s opinion on the procedures and records used to produce the statement regardless of whether material misstatement exist in the financial statements. There are basically four types of auditor’s opinion namely: unqualified, qualified, disclaimer and adverse opinion [2][4].

Unqualified Opinion is issued by an auditor when no significant limitations affect the performance of the audit and when there are no significant disagreements with management about matters affecting the financial statements.
Qualified Opinion is issued when the auditor could not report in the affirmative; as such he qualifies his report. The circumstances which might make an auditor to qualify his reports are uncertainty and disagreement.
Disclaimer Opinion refers to the situation where the auditor states that he is unable to form an opinion as to whether the financial statement gives true and fair view. This is caused by destruction of a major part of the accounting records, lack of control over cash receipts and lack of satisfaction.
Adverse Opinion is when the auditor states that in his opinion, the financial statements do not give a true and fair view. This is sometimes caused by inappropriate valuation of property.

THE TRUE AND FAIR VIEW CONCEPT
The concept of ‘true’ emphasize that information is factual and conforms to reality, not false. In addition, it implies that the information conforms to required standards and law. On the other hand, ‘fair’ represents that such information is free from discrimination and bias and is in compliance with expected standards and rules. In addition, true suggests that the financial statements are factually correct and have been prepared according to applicable reporting framework such as IFRS and they do not contain any material misstatements that may mislead the users such as errors and omissions [3].

Fair implies that the financial statement presents the information faithfully without any element of bias and they reflect the economic substance of transactions rather than just their legal form. The basic question that begs for answer is how true are the financial statements in the event of corporate collapse [16]. However, the known criteria which in some situations do not prove true are as listed below:
1) The requirements of statutes are complied with
2) All applicable accounting standards are complied with
3) Accounting policies are consistently applied in the period and in prior period.
4) Transaction and balance are complete, accurate and valid.
5) The view presented is consistent with the nature of business.
6) Transaction and balance have been properly classified and presented.

Despite all these measures and requirement, it is apparent that companies still failed and collapsed. Therefore, the truism of the financial statement is in doubt.

B. Theoretical Review
The theories that provide theoretical foundation for this study are Policeman theory, Agency theory and Stakeholder theory.
1) Policeman Theory: This was the most widely held theory in auditing until the 1940’s. Under this theory, an auditor acts as a policeman focusing on arithmetic accuracy and on prevention and detection of fraud. However, due to its inability to explain the shift of auditing to verification of truth and fairness of the financial statement, the theory seems to have lost much of its explanatory power [9].

2) Agency Theory: This analyzes the relationship between two parties; investors and managers. The agent (manager) undertakes to perform certain duties for the principal (investors) and the principal undertakes to reward the agent [7]. According to this theory, the role of the auditor is to supervise the relationship between the manager and owners. A gap expectation occurs when the distribution of the responsibility is not well defined. The responsibility of every part is well defined in the regulation. The managers and the owners have to realize that the auditor does not have responsibility of the accounting, but only see that the auditing is done properly [12].

3) Theory of Inspired Confidence: This theory was developed in the late 1920s by Dutch professor Theodore Limberg [13]. Limberg’s theory addresses both the demand
for and the supply of audit services. According to Limperg, the demand for audit services is direct consequences of the participation of outside stakeholders of the company. These stakeholders demand accountability from the management in return for their contribution to the company. Since information provided by the management might be biased, a possible divergence between the interest of management and outside stakeholders, audit of this information is required.

C. Empirical Review

Reference [8] carried out a study on true and fair view – a study of the implication of this concept with IAS and Swedish GAAP. The aim of this study was to examine how true and fair companies’ financial statements were, given the application of international accounting standard and generally accepted accounting principles of Sweden. The researchers adopted interview approach in the study, where a total of four IAS experts at the four major auditing firms in Sweden where interviewed. Other approach adopted were desk review of related interactive. The study revealed that the true and fair view opinion is very individual concept that may lack general acceptance. Therefore, it was believed that it is difficult for a particular financial system to give a true and fair view of the operations.

Reference [6] carried out a research on ‘the true and fair view’ concept in Lithuanian Accounting Regulation. The main objective of the study was to analyze how understanding of true and fair view concept was created in Lithuanian accounting regulation. The content analysis methodology was adopted by the researcher in analyzing understanding of truth and fairness. The study revealed that the concept of true and fair view of the position of the company at a particular point in time is elusive since truism of financial statements. The auditing exercise may lack general acceptance. Therefore, it was believed that it is difficult for a particular financial system to give a true and fair view of the operations.

Reference [5] carried out the study on the truth and fairness in accounting: A case of Polish transition economy. The purpose of study was to examine the extent to which true and fair view concept was applied and used in different economies. The researcher adopted empirical investigation to elicit the opinion of the experts and accountants in the different economies namely Singapore, Australia, New Zealand and United Kingdom. The study revealed that the concept of true and fair view does not, in a real sense of truism, reveal all material facts about the company’s affairs to the users. From the review so far made; there are glaring doubts over the meaningfulness of the true and fair concept.

III. METHODOLOGY

The authors adopted desk approach method in the paper. The data was sourced completely from the secondary sources. However, interviews were granted on the accounting practitioners and experts who offered their candid opinions on the subject matter. These opinions / suggestions form the basis of discussions on the study and the method of analysis was explanatory in nature.

IV. DISCUSSION OF FINDINGS

The adoption of the phrase ‘true and fair view’ of the affairs on the financial statements of companies was quite appropriate in years past. This is so because the level or degree of honesty exhibited by managers, accountants and auditors were adjudged average. There was strict adherence to professional ethics and the corrupt ingenuity of operators was at the lowest ebb. For financial statement to display the truism often expressed in the auditors’ opinion, a number of factors must be taken into consideration:

The use of estimation and approximation in arriving at a particular figure renders the concept of truism of the financial statements inappropriate, incorrect and misleading. This is based on the opinion of experts that the exactness and accurateness of the figure is influenced due to estimation and approximation of values and figures respectively. Often times, items are reclassified for statutory reasons when extended trial balance are drawn up during annual audit exercise, this in the expert views sometimes distorts the original classifications from the primary source. This could be as a result of lack of appropriate heading as well as the insignificant value of the amount.

Also, the deliberate suppression and omission of financial information useful for inclusion in the accounting records of an entity is a worrisome fact. Expressing ‘true view’ on the financial statements seem to be exaggeration and overstatement in the professional’s view since the information suppressed and omitted are not part of the financial data reported for informed decision making. This is observed as lacking truism in the true sense of it.

There are also errors in the accounting often committed by accountants either deliberately or inadvertently. When transactions are wrongly posted in the books of accounts and error of omission is committed, it helps to distort the facts and figures tendered and provide information that is incorrect. This may not be known but decision taken based on it will result in wrong outcome. This scenario raises the problem of the truism of the financial statements posited by the true and fair view concept of audit opinion of auditors.

Another dimension to this discussion is the manipulation and falsification of accounting records. Figures in the book of accounts are sometimes manipulated and falsified by corrupt and dishonest staff for their selfish interest. These acts help to destroy the transaction flow, correct picture and performance of the unit/department and ultimately churn out information from the system that turns out to be misleading.

The criminal ingenuity of shareholders, stakeholders and accountants in business and public offices is disturbing. Creative, window dressing and smoothening of financial position in many organizations assumed an alarming proportion in the recent times. This, in the opinion of experts is to help attract investors to the organization and win the heart of the creditors to freely give external credit facilities to such organization on false pretense. This is part of the causes of the crisis that was experienced in the corporate establishment in the recent past; with the fall of Enron in 2001, bank collapses in Nigeria are cases in point.

Value judgment of external auditors of corporations is another dimension that interviewers suggested to influence the truism of financial statements. The auditing exercise involved extraction, vouching, capitalization policy, preparation of annual reports of companies may in the process be distorted and opinion ultimately expressed, affect the decision of the users.
V. CONCLUDING REMARKS

The concept of “true and fair view” of the financial statements have been a long standing phrase often used by auditors of companies to express their opinion. This was appropriate in the circumstances of the past when the magnitude of criminal ingenuity of accountants were of a tolerable level. In our today’s economic systems, where a lot of unexpected events and activities are surging, the financial statements may not be as true as envisaged by the users and hence the phrase should change to read thus, “that the financial statements present fairly the state of the affairs of the organization”. This allows provisions, estimations and approximations, value judgment, reclassification and other similar auditing considerations. It is therefore recommended that the phrase should be changed by practitioners and auditors in order to situate the information content in the financial statements appropriately.

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