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## A Survey on Impact of Reliability of Audited Financial Statements on Investment and Granting Credits by Investors and Creditors

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### ABSTRACT

This paper intends to investigate the impact of reliability of audited financial statements on investment and granting credits by investors and creditors. In doing so, 75 and 83 individuals among the investors and creditors were selected as the statistical sampling. This paper is an applied research aimed to gain knowledge or understanding to meet a specific, recognized need, where its nature is from the correlative type. The instruments used to collect data include questionnaire where the correlation testing was used to measure hypotheses. The results show that there is a significant relationship between reliability of audited financial statements and investment and granting credits by investors and creditors.

**Keywords:** Reliability of Audited, Financial Statements, Granting Credit, Investors, Creditors.

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### Introduction

Reliability of audited financial statements is the leading cause for advancement among human beings. An investor who decides to purchase or sell stocks, the banking system taking action on confirming a demand for a loan and the government which relies on tax returns for the state's *tax collections* and *revenue* totals, all rely on the information gathered by others. Accordingly, most of the time, the purposes of Information providers are different from the users of those information whereby being in need of

independent auditors is a real fact needed to be come true (Accounting Standards, 2009). In addition to the conflicts of interest existing among information providers and users, the other factors including lack of access to the Information providers for the users, complexity of financial transactions and the expected impact of financial statements on decision makers can raise the need to auditing (Madani, 2004). According to increasing trend in expansion of companies and business units as well as their active

involvement in the capital market, and also based upon the increase of Community Recognition on auditing profession and identifying major roles and responsibilities of internal auditing having essential role in investigating how a useful investment can be proposed by auditing. In doing so, this paper intends to provide an in-depth survey on auditing profession based upon all the investments provided to date where on the investors' views on financial statements confirmed via this profession have been investigated in this paper so that this caused the investors increasingly get to know about the importance of this profession and its leading role on a useful investment.

### **Problem Statement**

Financial reporting within economic units indicate the information needs and different expectations of different users of financial statements including investors, creditors, government and managers who need such information to make accurate economic decision, planning, supervision and accountability.

A set of financial statements including Income Statement, Balance Sheet, and statement of cash flows, statement of changes in equity, notes and other disclosures is a structured representation of the financial performance and financial position of a business and how its financial position changed over time. Information used in financial statements comes useful for the users at the time while it includes quality characteristics required where one of the qualitative characteristics of financial information is reliability. Financial information while comes reliable by which the financial effects of transactions and other financial events to be measured impartially where on the results obtained from measurements can be authentic at this time. Users of financial statements can rely on financial information reflected in financial

statements at the time while a private, independent, competent and impartial person gives his view on the extent to which this information is authentic.

In the current economic-social systems, commenting on the financial statements is devolved upon independent auditors (audit organizations, Auditing standards, 2006, Preface). Audit report is the end product of an audit process mentioned as means for commenting on quality and content of financial statements. In other words, as the performance of economic units is defined by figures and statistics registered in financial statements, so the main responsibility of auditors is giving view and investigating the performance of managers working at government agencies and financial institutions (Chapter 57).

Investors, creditors and also the government severely desire to get to know about the companies' financial position where they usually draw attention to auditors' comments on financial statements. Most of the groups assume the auditor as a competent and impartial person who tends to comment on companies' financial statements so that he is assumed as an authority in decision making process of the ones who use the financial statements.

Although, the auditor is not responsible for the bankruptcy and/or upcoming events occurring in company, the studies indicate that the companies at which the auditor refrained from commenting on financial statements are subjected more to collapse rather than the companies at which the auditors' views helped for improvement of the companies (Lasanh and Nandarajan). Hence, it is believed that auditors' comments for users of financial statements came beneficial where this used as the main source for analysis of company (Mils and et al., 1998).

## The Research Objectives

This paper intends to investigate the impact of reliability of audited financial statements on investment and granting credits by investors and creditors.

## Research Hypotheses

There is a significant relationship between reliability of audited financial statements and Investments by investors.

There is a significant relationship between reliability of audited financial statements and Grant credits by creditors

## Research Background

Zahra Dia and colleagues in a research entitled "a survey on relationship between financial information and Risk Criteria in Tehran stock exchange", tended to investigate this issue proposed in this paper. The main aim of their study was to investigate the relationship between quality of financial Information and Risk Criteria in Tehran stock exchange.

In doing so, the financial information associated to 56 stock companies provided during conducting the research was analyzed using Structural equation approach.

In this paper, the variable of quality of financial information based upon the qualitative characteristics of information was quantified so that three variables including Systematic risk, volatility of stock returns and the ratio of book value to market value of equity have been used to measure the risk of stock.

The results show that, the more the quality of financial information is, the less the risk criteria would be, i.e. there is a negative relationship between the quality of financial information and risk criteria.

Bahman Banimahd in a research entitled "quality of accounting information, type of auditors and earnings management" examined this issue. This research aims to

examine earnings management and profitability index on quality of accounting information in the accepted companies in Tehran Stock Exchange for a 7-year period since 2002-2007.

The results of his study showed that the type of auditor and profitability indicators have a direct and positive relationship with quality of accounting information, but, there is a negative and inverse relationship between the earnings management and quality of accounting information.

The results show that improving the performance of managers and then increase of profitability of companies leads to improvement of quality of accounting information. Further, reduction in earnings management is another instrument for improving accounting quality. Separation of Ownership and Management can come useful to increase the quality of accounting information and decrease its costs. The evidences of the present paper show that privatization of audit and assigning some responsibilities of the organization to private institutes as well as increasing competition in the audit can lead to decrease of quality of accounting information.

Majed Sharayri and colleagues (2011) in a research entitled "a survey of the impact of reliability and financial information on information users' decision making" examined this issue in Electronics Industry in Jordan.

This study examined two characteristics of reliability and balance sheet evaluated the relationship between these two with each other in Electronics Industry in Jordan.

In this regards, 50 questionnaires distributed and the proper parameters for the data analysis including frequency, percentage, mean, standard deviation and T-test have been used. Some results from this study include the extent of reliability and balance sheet used in Electronics Industry in Jordan reported with high level, where these two

influenced the information users' decision making.

Enas Mahmoud Sa'ed Alabood et al. in a study entitled "The effect of using computer on the properties of the accounting information from the investors' point of view" examined this issue in Amman Financial Market.

Their study aimed to identify the quality of the accounting information sought by investors in Amman Financial Market to support their decision, and the limitation of the most important properties of the accounting information and declaring the range of the achievements in the accounting information from the adequate and reliability perspective in processing financial data, in addition to find out the effect of stability and comparability of the accounting information on assisting the investors' future predictions. They found that there is a positive statistical relationship between adequacy, reliability, stability, comparability and properties of the accounting information and the use of the computer. Their study recommended to adopt an integrated accounting information system including a central database with the accounting information system, and to develop the skills of investors in order to have access to all developments and changes that occur in this area.

Ümit Gümrah in a research entitled "Value relevance and reliability of goodwill and intangibles on financial statements: the case of Istanbul Stock Exchange" examined this issue. He showed that failure in reflecting the impact of intangibles on financial statements on the current and future market value of the company leads an investor that financial statements are insufficient to present an unbiased (true and fair) view of the firm's financial position. In that context the aim of this study is to examine financial reporting reliability of goodwill and intangibles and value relevance of financial reports. To observe the effects of accounting variables on market value of equity Feltham and Ohlson

Model (1995) is employed and panel data method is applied which handles both cross sections and time series. Results indicate that the abnormal operating earnings is the main market value driver whereas the coefficients of goodwill and intangibles imply that there is lack of reliability in financial reporting.

### **The Research Methodology**

The method used in this paper is used of a descriptive correlation method type by which it was strived to define the relations among the research variables using the correlation coefficient. On the basis of an overview on data, this study is such a casual type because data from previous years have been examined in it. Further, this paper is characterized in applied research based on its purposes.

This paper is an applied research aimed to gain knowledge or understanding to meet a specific, recognized need, where its nature is from the correlative type, mentioning that the results from this paper can be used for a wide spectrum including company directors, shareholders, investors, creditors, researchers and developers of standards. The instruments used to collect data include questionnaire where the correlation testing was used to measure hypotheses. The results show that there is a significant relationship between reliability of audited financial statements and investment and granting credits by investors and creditors.

Each of financial managers at investment companies within Tehran Stock Exchange, individual investors and credit *managers* working at banks and financial institutions received a questionnaire in addition to a manifesto containing the purposes and characteristics of study, moral commitment to the confidentiality of the data and advantages coming from inviting the participants in the study.

**Statistical Sample and Population**

The statistical population entails all the Shareholders and potential and actual investors in the Tehran Stock Exchange, mentioning that the banks are those creditors providing the credits for the companies. To select the sample size, the formula as following is used:

The confidence level equal to 95% is assumed in formula above.

$$Z_{\alpha/2} = Z_{0.025} = 1.96 \quad n = \frac{Z_{\alpha/2}^2 \cdot p(1-p)}{\epsilon^2}$$

**The Statistical Methods used for the Data Analysis**

To analyze the hypotheses of research based upon the level of measurement and type of variable, the associated tests have been used. Followed by gathering questionnaires, data were analyzed in two sections including

descriptive and inferential statistics. The statistical analyses including frequency and percentages have been used in the descriptive part where the statistical correlation analysis has been used to investigate the relationships existing among the variables in inferential part.

**Data Analysis**

**Descriptive Statistics of Data**

Within the descriptive methods, it is striven to provide table and use the descriptive statistics tools including measures of central tendency and dispersion in order to define the data of research where this helps for making the issue clear here.

Descriptive Statistics dedicated to creditors and investors have been proposed in table 1.

**Table 1.** Descriptive Statistics of Data

	No. of observations	Minimum	Maximum	Mean	Standard deviation	Totally agree	agree	Neutral	disagree	Totally disagree
creditors	83	1	5	1/78	0/88	36	24	7	9	7
investors	75	1	5	2.57	1.48	26	17	4	19	9

According to 158 questionnaires received and reviewed, 75 questionnaires associate to the investors and the remained belong to the creditors. The mean of the responses received from the creditors show the respondents' more tendency toward the option "totally agree" where 36 responses to this option confirm this fact.

Although the highest frequency of Likert spectrum associates to the option "totally agree" among the investors, due to the increasing number of the respondents with against view (19 viewpoints), the mean dedicated to investors is higher than the mean for the creditors. The higher dispersion of the investors' views towards the questionnaire leads to the higher standard deviation confirming it.

**Data Normality Tests**

The starting point of the test is the very determining the normality level of research data. To examine the normality of data and residuals, One-Sample Kolmogrov-Smirnov Normality test has been used. If the value of this test be greater than 0.05, so the normality of variables distribution can be confirmed by 95% confidence level, and vice versa. The results from the testing showed in table 2 show that lack of normality of variables distribution in variables. As shown in table 2, the value of significance level associated to data for creditors and investors is less than 0.05, so the data cannot be tested through the parametric test.

**Table 2.** Data normality test

Data normality tests		
Statement	Sample Kolmogrov-Smirnov Normality test	Significance level
creditors	2.36	0.00
investors	1.94	0.001

**Inferential Statistics**

The statistical techniques using in each research are selected based upon the necessity of research and for the purpose of rejecting or confirming the research hypotheses. Pearson correlation technique has been used to test the research hypotheses. SPSS software has been used to test all the analyses.

**Hypothesis Testing**

In general, each hypothesis testing is assumed to determine whether an assumption brought about the characteristic of a society is confirmed or not. This

assumption based upon the purpose of research includes the statement about the value of a population parameter. Indeed, any rule about a population is assigned to statistical hypothesis where its acceptability has to be based on the information from the population sampling.

First hypothesis: There is a significant relationship between reliability of audited financial statements and Investments by investors.

$$H_0:\beta=0$$

$$H_1:\beta\neq 0$$

**Table 3.** The results from the correlation existing

Dependent variable	independent variable	The correlation coefficient	The coefficient of determination	Error level	Sig.
Investments by investors	reliability	0/474	0/225	0/05	0.002

According to table 3, it can come to an end “There is a significant relationship between reliability of audited financial statements and Investments by investors”.

So, as there is sig < 0.05, it can say that there is a significant relationship between these two variables referring to 95% confidence level. In other words, H<sub>0</sub> and H<sub>1</sub> is rejected and confirmed, respectively. Hence, this relationship is positive and direct, meaning

that the more reliability of audited financial statements would lead to increase of investments by investors.

Second hypothesis: There is a significant relationship between reliability of audited financial statements and granting credits by creditors

$$H_0:\beta=0$$

$$H_1:\beta\neq 0$$

**Table 4.** The results from the correlation existing between reliability of audited financial statements

Dependent variable	independent variable	The coefficient of determination	The correlation coefficient	Error Level	Sig.
granting credits by creditors	reliability	0/313	0/559	0.05	0.000

According to table 4, it can come to an end “There is a significant relationship between reliability of audited financial statements and granting credits by creditors”.

So, as there is sig < 0.05, it can say that there is a significant relationship between these

two variables referring to 95% confidence level. In other words, H<sub>0</sub> and H<sub>1</sub> is rejected and confirmed, respectively. Hence, this relationship is positive and direct, meaning that the more reliability of audited financial statements would lead to increase of granting credits by creditors.

**Table 5.** Summary of both

Dependent variable	independent variable	The coefficient of determination	The correlation coefficient	Error Level	Sig.
Investments by investors	reliability	0/225	0/474	0/05	0.002
granting credits by creditors	reliability	0/313	0/559	0/05	0.000

According to table 5, one cans statement that:  
 1-financial statements in terms of both groups, investors and creditors, have substantial reliability.

2-although research hypotheses have been approved, the reliability of financial statements for creditors is more than the ones for investors, so it seems that the reasons as follows exist:

More specialized dealing with financial statements and analysis of them as well as exploiting from them by creditors

Lack of proficiency in investors for the purpose of investing and analysis of information registered in financial statements.

Several consultants’ and experts’ assistance in investing on financial statements.

**Conclusion**

With regard to the results from the first hypothesis based upon a significant relationship between reliability of audited financial statements and Investments by investors, this relation is a direct and positive type of relationship, i.e. the more reliability of audited financial statements would lead to increase of investments by investors. To get the users of financial statements assured in access to the information without any mistakes as expected, it is recommended to the stock exchange organization to codify instructions

based upon needs of the companies accepted in stock exchange in order to provide financial statements where on observing the quality of information in financial reports is essential, mentioning that terms and conditions for the standards to reduce the qualitative characteristics are needed.

With regard to the results from the first hypothesis based upon a significant relationship between reliability of audited financial statements and granting credits by creditors, this relation is a direct and positive type of relationship, i.e. the more reliability of audited financial statements would lead to increase of credits by creditors. To get the users of financial statements assured in access to reliable information and disclosure of the methods used in providing financial statements and lack of using the specific accounting methods to distract the users, it is recommended to stock exchange organization to draw attention on the necessity of defining the information to the users.

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