

## Measuring the Impact of Business Risks on the Quality of the Auditing Process

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### ABSTRACT

This study aimed to measure the impact of business risk on the quality of the auditing process, from the perspective of auditors and the audit staff in the licensed operating offices to peruse the profession in the Jordan By distributing a questionnaire to them, they are (82) licensed office allowed to practicing the profession work out to about (325) auditor. And the researchers came up with a number of findings among which the most important ones are: That there is an evidence for the regulatory risks, environmental risks and occupational risks on the quality of the audit process from the perspective of the auditor.

In the light of these findings, there are some recommendations. There should be work to increase interest of administrations of offices of systematic risks as they affect the quality of the audit process, There should be work to increase the attention of administrations of offices of audit of environmental risks through the study and analysis of the environmental performance of the company in order to ensure its ability to respond to the current laws on the protection of the environment. And there should be work to increase the interest of administrations of offices of audit of occupational risk with a need to analyze all the risks associated with the activities of the organization, and having examined the risks associated with each activity.

**Key Word:** Business Risks, external auditors, quality of auditor's process.

### 1. INTRODUCTION

A modern business environment Witnessing rapid changes in various fields, and global challenges of large-scale, represented by the globalization of the economy and spread of information and the Internet and other things, that have made the business environment, an environment characterized by complex and severe competition, in

addition to the contribution of these challenges and changes in increase demand for products and services that are characterized by high quality.

Auditor presents an important role in the business environment in contemporary organizations, where multiple parties rely on the services provided in the decision-making which related to work of organizations. This represented in the quality of the audit process by the auditor. In order to present a requested services and work on improving it.

Although some researcher have paid attention to business risks in auditing process, Tusek, Boris,& Pokrovac, Ivana.(2010). they concentrated on the role and importance of the internal audit function in the risk management process, and also the implications of the internal audit involvement in that process on its own activity.

In a study conducted by van Buuren, Joost & others (2014), investigates the role of business risk perspectives in the audit of smaller and medium-sized entities (SMEs) by small and medium-sized audit practices (SMPs). This research focuses on knowledge of how SMPs utilize business risk factors, and there is a current debate about the need for proportionally applying auditing standards, including standards for business risks, in the audit of SMEs. They conduct 38 interviews with Dutch and German auditors of both small and medium-sized audit practices to capture a variety of different audit environments. Then they develop a model that considers a continuum of audit approaches ranging from a substantive-based audit approach to a full-scope business risk audit, and observe a limited and heterogeneous application of business risk perspectives by SMP auditors. They find that client complexity, enforcement by audit supervisory authorities, the relative emphasis on book-tax alignment in different countries, and investments in audit technology are important factors explaining the use of business risk perspectives. The findings imply a need to provide auditors with sufficient flexibility to proportionally adjust their audit approaches in the application of international audit standards under varying client and audit firm conditions.

In other study conducted by Lam and Mensah, (2006). In order to study the relationship in the decision by the auditors in light of the uncertainty about continuity , through the dangers of judicial legislation, have agreed a study result with result of other studies, that the reputation of the auditor and the profession affect strongly on his behavior when expressing an opinion (especially opinion modifying ), and some auditors tend to disclaimer of opinion in critical situations resulted by the financial calamities, or issuing opinion with an explanatory paragraph when these calamities are less severe, as well as it has shown that the impact of professional pressure on auditors when issuing opinion be more influential than the risk of lawsuits.

In this study, the authors will measure the impact of three kinds of business risks and its impact on the quality of the auditing process.

Some studies suggest the importance of business risk for the exercise of the profession for the auditor, since these risks have not yet attained to the sufficient portion in the legislation and the regulations issued by the World Professional organizations, it remains an important focus of research in the audit, There are many risks associated with the business aspects, make it affect the audit process for the auditor, which

requires to give them special attention, so that it can be identified and adjusted, so as to raise the level of the audit process provided by the auditor.

To achieve the purpose of the study by answering the following questions:

1. Is there an effect of systematic risk on the quality of the audit process?
2. Is there an effect of environmental risk on the quality of the audit process?
3. Is there an effect of occupational risk on the quality of the audit process?

This study aims to measure the impact of business risk on the quality of the audit process, and so from the viewpoint of auditors working in audit firms operating in Jordan, is also trying to identify the extent of compliance between realities of business risk with the theoretical framework in the audit field.

## **2. LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT**

### **2.1 The concept of risk**

Risk is the potential for losses, either directly through business results losses or in capital, or indirectly through the presence of restrictions limiting the organization's ability to continue to provide work activities on the one hand, and limit their ability to exploit the opportunities available in the work environment On the other hand, Alqarey. (2004).

### **2.2 Business Risk**

business risk Represent losses or damage incurred by the audit office or auditors working in the office as a result of factors related to conducting an audit or Engagement with the client, auditor may be exposed to business risk, not because of audit process failure, or the lack of commitment to professional and ethical standards, but back to reasons of about his relationship with the client, Bushong and Weatherhold. (2012).

Defines business risk as “the risk that will make the audited company, fail to achieve its objectives” Beattie, et al, (2002). Also define as "the risk that the auditor will suffer them or audit office as a result of the relationship with the client, even if the audit report is true” Arens & Loebbecke, (2012), or “a risk resulting from significant conditions, events, circumstances, actions or inactions that could adversely affect an entity’s ability to achieve its objectives and execute its strategies, or from the setting of inappropriate objectives and strategies”, IAASB. (2012). Researchers believe that the auditor has to start from the maximum permitted audit risk level according to generally accepted auditing standards, then making this level of audit risk at lower a level based on the professional judgment.

#### **2.2.1 The main elements of business risk in the audit**

The main elements of business risk in the audit appear in tow important elements:

**2.2.1.1. Litigation risk:** Risks sue auditors Considered of the important factors that affect the auditing profession on the one hand, and on accounting information and auditing profession in general, on the other hand the risk As is known, the accounting and auditing profession working to solve problems relating to litigation, through reforms in the laws and regulations that define how to do these operations, therefore, there was three main characteristics of lawsuits against auditors are: , Lys,T. and Watts, (2004)

1. The existence of the lawsuit, which depends on three main factors are:

**1.1.** The likelihood that the board of directors may be issued misleading or incorrect financial statements.

**1.2.** The likelihood that the auditor may fail to detect that the misleading or incorrect financial statements or that he discovered it but failed to report it.

**1.3.** The existence of the loss suffered by the plaintiff.

**2.** Revealed Plaintiff to the lawsuit.

**3.** The benefits Existence of lawsuit process.

**2.2.1.2. Sanctions:** sanctions imposed by private or public regulatory authorities , as is the case with the Securities and Exchange Commission , or professional authorities , and these sanctions cause damage to the auditor, whether through bear additional costs as a result of doing audited the additional counterpart, or through a ban on checker to accept any clients whose are subject to the laws of the stock exchange during a specified period, Brumfield, et al. (2003). Sanctions Include imposed by professional organizations, sanctions or disciplinary sanctions, the following (IFAC, 1998):

**1.** Reprimand

**2.** Financial penalty

**3.** Payment of certain costs.

**4.** Withdrawal of practice rights

**5.** Temporary suspension from practice

**6.** Other sanctions, including re-fees to the client, additional training and education.

### **2.3. The relationship between audit risk and business risk for the auditor**

Auditing standards require the auditor to obtain an understanding of the entity and its environment, including its internal control, to assess the risk of material misstatements in the client's financial statements; Auditing standards require the auditor to assess the risk of material misstatements at the overall financial statement level, as well as the relevant assertion level for classes of transactions, account balances, and disclosures. The auditor develops audit objectives for each assertion. Thus, our references to audit objectives encompass the assertions for classes of transactions, balances, and presentation and disclosure. Auditors consider these risks in planning procedures to obtain audit evidence primarily by applying the audit risk model, the audit risk model helps auditors decide how much and what types of evidence to accumulate for each relevant audit objective. It is usually stated as follows, Arens & others. (2014).

$$PDR = \frac{AAR}{IR \times CR}$$

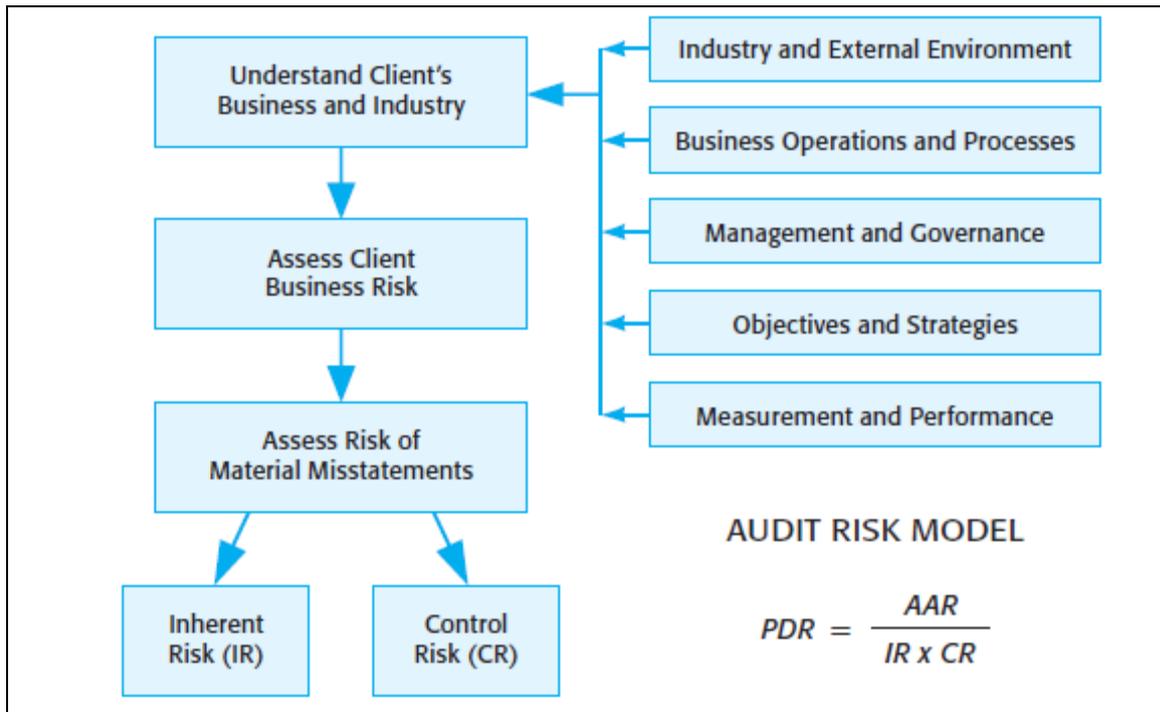
*PDR* = planned detection risk

*AAR* = acceptable audit risk

*IR* = inherent risk

*CR* = control risk

The following figure shows the relationship between the audit risk model and the understanding of the client's business and industry. Auditors use the audit risk model to further identify the potential for misstatements in the overall financial statements and at the audit objective level for specific account balances, classes of transactions, and disclosures where misstatements are most likely to occur.

**Figure 1: Audit risk model and understanding the client's business and industry**

The components of audit risk model accordance to ISA 315: Arens & others. (2014).

**2.3.1.** Planned detection risk is the risk that the audit evidence for an audit objective will fail to detect misstatements exceeding performance materiality. There are two key points to know about planned detection risk. Planned detection risk is dependent on the other three factors in the model. It will change only if the auditor changes one of the other risk model factors. Planned detection risk determines the amount of substantive evidence that the auditor plans to accumulate, inversely with the size of planned detection risk. If planned detection risk is reduced, the auditor needs to accumulate more evidence to achieve the reduced planned risk.

**2.3.2.** Inherent risk measures the auditor's assessment of the susceptibility of an assertion to material misstatement, before considering the effectiveness of related internal controls. If the auditor concludes that a high likelihood of misstatement exists, the auditor will conclude that the inherent risk is high. Internal controls are ignored in setting inherent risk because they are considered separately in the audit risk model as control risk.

**2.3.3.** Control risk measures the auditor's assessment of the risk that a material misstatement could occur in an assertion and not be prevented or detected on a timely basis by the client's internal controls. Assume that the auditor concludes that internal controls are completely ineffective to prevent or detect misstatements.

**2.3.4.** Acceptable audit risk: is a measure of how willing the auditor is to accept that the financial statements may be materially misstated after the audit is completed and an unqualified opinion has been issued. When auditors decide on a lower acceptable audit risk, they want to be more certain that the financial statements are *not* materially misstated.

## 2.4. RESEARCH HYPOTHESES

Study is based on the following main hypotheses:

H1: There is No statistically significant effect at the level of significance  $\alpha \leq 0.05$  to the systematic risk on the quality of the audit process.

H2: There is No statistically significant effect at the level of significance  $(\alpha \leq 0.05)$  to the environmental risk on the quality of the audit process.

H3: There is No statistically significant effect at the level of significance  $\alpha \leq 0.05$  to the occupational risk on the quality of the audit process.

## 3. METHODOLOGY

### 3.1. Population and the Study Sample

The study population consists of audit offices in Jordan, that are (82) offices at the time of the study, the study questionnaire was addressed to the auditors working in these offices, The study sample was chosen from auditors working in audit offices in Amman, the method in the selection of a sample study is Convenience Sample: "A sample where the selection units from the population through the availability of appropriate persons to be distributed". The questionnaire has been distributed by hand in a sample of the study, the number of questionnaires that were distributed was (325) questionnaires, (284) questionnaires were recovered which were suitable for analysis. Thus, the percentage of recovered and valid questionnaires for analysis is (87.4%).

### 3.2. Data collection

Been relying on two types of information sources are secondary sources, such as accounting books and scientific articles, and specialized periodicals that are looking at the subject of business risks and the quality of the audit process, also relied on primary sources through the development of a questionnaire, for sure of the sincerity and the ability to measure the variables of the study, it has been presented to the jury of accounting professors, in addition to that was extracted Cronbach's alpha coefficient for internal consistency and was (95.89%). the questionnaire included 15 questions to measuring the impact of business risks on the quality of the auditing process from the point of view of the auditor.

And for stability test, Cronbach's alpha test was used to measure the stability of the measuring tool as the value of  $\alpha = 73\%$  which is an excellent rate being higher than the acceptable 60%, and using Simple Regression to test the hypotheses

## 4. DATA ANALYSIS AND HYPOTHESIS TESTING

The Arithmetic means and standard deviations for the variables of Business Risks, and Quality of The Auditing Process, explained in the following tables:

**Table 1:** Arithmetic means and standard deviations for independent variable questions (systematic risk) (n=284)

Number	Statement	The Arithmetic Mean	Standard Deviation	Ranking
1	Ensure that the management entrenched the principle of commitment to all shareholders	3.742	0.9131	2
2	The company's management realizes that all the risks have been properly managed	3.985	0.9576	1
3	formation of a committee to review the policies and risk management strategies	3.491	0.9338	3
	<b>Total Field/</b> systematic risk	3.739	0.9348	Average

Table no. (1) shows the degree of The systematic risk measurement in all paragraphs are high and average, the arithmetic mean ranged between (3.985-3.491), paragraph (2) occupied the first rank, with the arithmetic mean of (3.985), and paragraph (3) occupied the last rank, with the arithmetic mean of (3.491), the arithmetic mean of the total field / The systematic risk was (3.739) with an average degree.

**Table 2:** Arithmetic means and standard deviations for independent variable questions (environmental risk) (n=284)

Number	Statement	The Arithmetic Mean	Standard Deviation	Ranking
4	Ensure management's ability to deal with surrounding environmental data	3.482	0.9485	3
5	Verification of calculating and recording the depreciation of assets pollution treatment separately from the rest of company's assets	3.722	0.9323	2
6	analysis and Study of the environmental performance of the company and its ability to respond to the current environment protection laws and regulations	3.962	0.8055	1
	<b>Total Field/</b> environmental risk	3.722	0.8988	Average

Table no. (2) shows the degree of The environmental risk measurement in all paragraphs are high and average, the arithmetic mean ranged between (3.962-3.482), paragraph (6) occupied the first rank, with the arithmetic mean of (3.985), and paragraph (4) occupied the last rank, with the arithmetic mean of (3.482), the arithmetic mean of the total field / The environmental risk was (3.722) with an average degree.

**Table 3:** Arithmetic means and standard deviations for independent variable questions (occupational risk) (n=284)

Number	Statement	The Arithmetic Mean	Standard Deviation	Ranking
7	The ability of auditors in exploit their different abilities in the best way and applied it appropriately	3.530	0.8161	3
8	Analysis of all the risk associated with organization activities	3.846	0.7696	1
9	Benefits gain from the internal auditor in determining risks	3.730	0.8616	2
	<b>Total Field/</b> occupational risk	3.735	0.8157	Average

Table no. (3) shows the degree of The occupational risk measurement in all paragraphs are high and average, the arithmetic mean ranged between (3.846-3.530), paragraph (8) occupied the first rank, with the arithmetic mean of (3.846), and paragraph (7) occupied the last rank, with the arithmetic mean of (3.530), the arithmetic mean of the total field / The occupational risk was (3.735) with an average degree.

**Table 4:** Arithmetic means and standard deviations for dependent variable questions (the quality of the auditing process) (n=284)

Number	statement	The Arithmetic Mean	Standard Deviation	Ranking
10	Auditors decisions affect the quality of audits	3.918	.9162	4
11	distinguished auditor performance during and after the process of auditing	3.770	.8243	7
12	auditor's ability to detecting financial contraventions	3.877	.8969	6
13	auditors possess a degree of professionalism and professional knowledge about applying auditing procedures	3.775	.8521	1
14	ability to reduce the risk of presence errors in the financial statements	3.478	.9570	5
15	Audit reports help improving the quality of the company financial reports	3.815	.8903	2
	<b>Total Field /</b> the quality of the auditing process	<b>3.772</b>	<b>.8894</b>	<b>High</b>

Table no. (4) shows the quality of the auditing process measurement in all paragraphs are high, the arithmetic mean ranged between (3.478-3.918), paragraph (10) occupied the first rank, with the arithmetic mean of (3.918), and paragraph (14) occupied the last

rank, with the arithmetic mean of (3.7523) , the arithmetic mean of the total field / the quality of the auditing process was(3.478) with a High degree

#### 4.1. Testing Results of the hypotheses of the study using linear regressions

Table 3: The results of testing simple linear regression for the effect of business risk (systematic risk, environmental risk, and occupational risk) on the quality of the auditing process (n=284)

Independent variable	Sig.	R <sup>2</sup>	Beta	Calculated (t)	Table (t)	Statistical decision
systematic risk	0.000	.226	1.187	6.590	1.648	reject
environmental risk	0.000	.231	1.008	3.609	1.648	reject
occupational risk	0.000	.273	1.126	3.469	1.648	reject

##### 4.1.1 First hypothesis test

Depending on the results shown in the table above, calculated (t) was (6.590) and table (t) was (1.648) after comparison between the two results the Statistical decision accepts the alternative hypothesis (There is statistically significant effect on the systematic risk on the quality of the audit process) this is confirmed by value of significance (Sig.) Amounted zero, where it is less than 5%.

##### 4.1.2 Second hypothesis test

Depending on the results shown in the table above, calculated (t) was (3.609) and table (t) was (1.648) after comparison between the two results the Statistical decision accepts the alternative hypothesis (There is statistically significant effect on the environmental risk on the quality of the audit process) This is confirmed by value of significance (Sig.) Amounted zero, where it is less than 5%.

##### 4.1.3 Third hypothesis test

Depending on the results shown in the table above, calculated (t) was (3.469) and table (t) was (1.648) after comparison between the two results the Statistical decision accepts the alternative hypothesis (There is statistically significant effect on the occupational risk on the quality of the audit process) This is confirmed by value of significance (Sig.) Amounted zero, where it is less than 5%.

## 5. RESULTS

The study reached several results including the following:

**5.1.** The results indicated to presence an impact of the systematic risks on the quality of the audit process from a point view of auditors. Results reveal that Organization's management realized that all the risks have been properly managed and the management bears all responsibilities concerning the safety of financial operations.

**5.2.** The results indicated to presence an impact of the environmental risks on the quality of the audit process from a point view of auditors. Results reveal the need for analysis and Study of the environmental performance of the company and its ability to respond to the current environment protection laws and regulations.

**5.3.**The results indicated to presence an impact of the occupational risks on the quality of audit process from point view of auditors, Results reveal that need to Analysis of all the risk associated with organization activities, examine the risks associated with each activity, and Benefits gain from internal auditor in determine risks

## 6. RECOMMENDATIONS

Depending on the results, the following recommendations were achieved:

**6.1.** There should be work to increase the interest of administrations of offices of regulatory risks as they affect the quality of the audit process.

**6.2.** There should be work to increase the attention of administrations of offices of audit of environmental risks through the study and analysis of the environmental performance of the company in order to ensure its ability to respond to the current laws on the protection of the environment.

**6.3.** And there should be work to increase the interest of administrations of offices of the audit of occupational risk with a need to analyze all the risks associated with the activities of the organization.

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