European Journal of Accounting, Auditing and Finance Research
Vol.4, No.4, pp.18-24, April 2016
Published by European Centre for Research Training and Development UK (www.eajournals.org)

THE EFFECT OF AUDIT REPORT ON INVESTMENTS AND LENDING DECISIONS IN GHANA

Evans Kelvin Gyau[1], Frank Owusu[2] and Newman Amaning[1]

[1]Sunyani Polytechnic
[2]Koforidua Polytechnic

ABSTRACT: *The Purpose of this research was to find out whether loan and investment decisions will differ if the loan or investment request was accompanied by audited Financial Statement from loan and investments amount granted when the when the loan and investment request is not accompanied by audited Financial Statement.. An experiment involving 68 loan and investment officers was performed. We manipulated the presence of audited Financial Statement (Audited Vs unaudited Financial Statement.) Our main findings were that the mean loan amount differ when loan application is accompanied by audited accounts from when loan applications are accompanied by unaudited accounts. We also found that investment decisions when accounts are audited differ from investment decisions taken when accounts are not audited. We observed that the mean loan and investment amount was larger when there was an audited Financial Statements.*

KEYWORDS: Loan decisions, Investment Decisions, Experimental Design, Financial Statements.

INTRODUCTION

This paper assesses the effect of audited financial statement on loan and investment decisions in Ghana. In Ghana the Companies' Code 1965 ACT 179 requires Annual Reports and Financial Statements to be produced by all business entities at regular intervals usually twelve months. The statements are considered an important means not only for gauging the performance of the entity but also for understanding how money invested in the entities has been used and enabling those interested in the entity to make pertinent decisions. These report include among other reports the audited Financial Statements. Auditing is an investigating process that can produce useful judgmental information and generally do not produce new economical information, but can verify provided economic information by the accounting process and diminish the value of the information by disaffirmation of provided information (Ahmadi, Sedghiani & Jamali, 2014).The importance of audit has been emphasized by several authors and stakeholders. According to Moradi, Salehi, Rigi & Moeinizade (2011) audit report is the consequence of auditing process and it is a major instrument of communication between auditor and financial statements' user. Asare and Wright (2009) was of the opinion that the objective of the unqualified standard audit report (SAR) is to add credibility to management's Financial Statements and facilitate decision making. Accordingly (Thuneibat et al., 2007 ; Salehi, 2009) asserted that if the audit report is objective and comprehensible, it can be a communicative media between the auditor and the audit reports' users, and because of its relevance it can make difference in decision making, otherwise, the users of the financial statements will not use the report in the decision-making process. According to IASB (2010) framework for financial reporting the purposes of Financial Statements is to provide useful information to present and potential investors as well as providers of resources. It follows that audit reports will be essential element in the decision making process of lenders as well as investors. Even though several studies { Asare & Wright, 2009; Guiral-Contreras et al 2007; Firth 1978; Nadàa Hachicha & Ali Omri, 2012} has been carried out in developed economies about the effect of audit report, to the best of the authors knowledge no such study in has been done in an experimental setting in Ghana. In this study we investigates the effect that audited financial reports have on lending and investment decision. We study bank loan and investment officers because this group of users routinely analyses financial data and has an inherent interest in the reliability of such data (Schneider & Church, 2007). We conduct an experimental study to investigate whether the external auditors report has an effect on officers' likelihood of granting a loan or making an investment in hypothetical company. The use of an experimental approach allows us to completely control the information that is available to participants and enable one to control for factors that can create challenges for archival researchers, including concurrent information disclosure, firm-specific characteristics, and self-selection. (Schneider & Church, 2007). In our experimental study, we manipulate the presence of audit report (Audited versus non Audited) on lending and Investment decisions. The manipulation allows us to determine whether audited report has effect on lending and investment decisions. The remainder of this paper is organized as follows. The next section reviews the relevant literature and provides a basis to develop the research hypotheses. Then, we describe the research method and present our results. Lastly, we offer concluding remarks.

LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

Many financial decisions can be made by several parties based on these audited Financial Statements. The auditor's report including Financial Statements is considered as a trusted informational frame for many financial decisions. Ahmadi et al (2014) were of the view that capital investors who want to buy or sell stocks, a banker who decide about verification of a loan request will all rely on audited accounts. Audit reports support information provided by Financial Statements. This view has been reiterated by Hoti, Ismajli, Ahmeti, & Dërmaku (2012) who opined that audit reports supplement the accounting information drawn from the Financial Statements. They provide a means of increasing the credibility of management disclosures. Thus the combination of audit reports and Financial Statements data can be a good predictor of several business events. Guiral & Ruiz (2010) posits that since the aim of the audit report is to allow Financial Statement users to assess the credibility of accounting information, it helps financial Statements users enhance their ability to make rational economic decisions about the company. Noghondari & Foong (2009) asserts that one of the observed phenomena in the current highly competitive business environment is the growing complexity of business models and their operations. Consequently, external users of corporate Financial Statements are increasingly relying on external auditors to assure them that the financial information disclosed in corporate Financial Statements is reliable. Several papers conclude that qualified audit reports do not provide any specific information useful for Financial Statement users beyond that contained in the Financial Statements themselves. Libby (1979) found no evidence that qualified audit reports (general uncertainty) affect lending decisions of U.S. loan officers. Gómez-Guillamón (2003) undertook a survey aimed at finding out exactly how important the audit report is in the investment decisions that analysts make, as well as in lending decisions made by credit institutions. In this sense, the respondents were asked about the source they consider relevant when making decisions, that is to say, the influence the auditor's opinion (clean, qualified, adverse or disclaimer) has when investing in and financing companies. The results show that users of audit reports consider the information provided in the auditor's opinion as useful and important when making decisions, both regarding their decisions of investing in and financing companies as well as the amount of the investment or the loan to grant. Bessell, Anandarajan & Umar (2003) examined whether modification/qualification by an auditor in Australia (an 'Emphasis of Matter' and an 'Except for' report, respectively) has information content to a user. The results indicate that for a company in a state of financial distress, the modification, in either form, does not appear to significantly enhance either perceptions of risk or decision-making. Firth (1978) used the market model to measure the abnormal returns associated with various "types" of qualification. It was found that some types of audit qualification had a significant impact on investment decisions while others had very little. There was found to be no relationship between the accounting firm qualifying the accounts and the abnormal returns. Guiral-Contreras, Gonzalo-Angulo, & Rodgers (2007) examined the significance of the audit report in loan rating decisions using the belief revision model. The authors designed a laboratory experiment where the sign of the audit report is mixed with other annual financial information in a series of sequential evidence. The results of an experimental design, using 106 loan officers from international financial institutions, support the hypothesis that the qualified audit report appears to be an independent and useful piece of evidence when it is contrary to favourable financial

ISSN 2054-6319 (Print), ISSN 2054-6327(online)

expectations. Their findings also support that the 'recency effect' might influence international commercial loan officers' perception of the qualified audit report. Schneider & Church (2008) suggested that an adverse internal control opinion can undermine the assurance provided by an unqualified opinion on Financial Statement taken as a whole and have negative effect on lenders assessment. Their experimental sample of 111 loan officers showed that the lenders' assessment of the risk of extending a line of credit and the probability of extending the line of credit are negatively affected when the company receives an adverse internal control opinion as compared to an unqualified one. Anvarkhatibi, Safashur & Mohammadi (2012) investigated the effect of auditor's opinions on shares prices and returns in Tehran Stock Exchange. The researchers found that there is no significant effect of the auditors' opinion on share prices and returns in Tehran Stock Exchange. Originally, that is, no information content of the audit opinion in decision making. In another study Moradi et al (2011) sought to find out whether the audit report in Tehran Stock Exchange (TSE) have information content ; whether Financial Statements' users emphasize auditing result as an information source? And whether audit report (especially qualified opinion) is relevant for decision making? The result of the survey indicated that qualified audit opinion has no significant effect on share prices and returns. In other word, there is no information content in qualified audit opinion in Iran. This conclusion may suggest that the audit report's users' do not understand its meaning or appreciate its value. Elias (2008) investigated Financial Statements, Attestation Level and Lending Decision by Small Banks. His survey results of 55 loan officers from 6 small banks indicate that while Financial Statements are perceived as important information in the loan decision of small banks, loan officers may not adequately consider the credibility of the Financial Statements when evaluating loans. Asare & Wright (2009) also found that participants rated the standard audit report (SAR) as important in investing and lending decisions. Kitindi, Magembe & Sethibe (2007) investigated Lending Decision Making and Financial Information: The Usefulness of Corporate Annual Reports (CAR) to Lenders in Botswana. From their study it was found that information from the income statement and other information in the CAR, together with information obtained through discussions with prospective borrowers are the main sources of information to lenders. Finally, the results indicate that the audit report is used by all formal lenders.

From the foregoing we posit that

H_1: **The mean loan amount granted will not differ whether or not the loan application is accompanied by an audited Financial Statement.**

H_2: **Investment decisions will not differ whether or not there is an audited Financial Statement of the Investee Company**

METHODOLOGY

The experimental setting involves commercial lending and Investment decisions. Bank loan and investment officers are given questionnaires (included in the appendix) containing information about a hypothetical company, with background information, size of loan and Investment request , collateral, and the company's most recent balance sheet, income statement, and statement of cash flows. We manipulate the presence of an audited report. The experimental task is to assess: (1) the probability of investing in the company and (2) the probability of extending the loan. To administer the questionnaire, one of the authors called Bank branches and spoke to Bank branch managers, Branch accountants and loan officers, asking them to participate in a research study dealing with the use of accounting information in commercial lending and Investment decisions. Personal contacts with the Banks were also used. Many indicated a willingness to participate in the study. The dependent variables in the study are the amount of loan granted (LNGRANT) and the Investment made (INVMADE) resulting in a 1 x 2 between subjects design. 68 responses were received. The average number of years' experience for the respondents was 8 years. 12 respondents were male whereas 54 respondent were male.

ISSN 2054-6319 (Print), ISSN 2054-6327(online)

European Journal of Accounting, Auditing and Finance Research
Vol.4, No.4, pp.18-24, April 2016
Published by European Centre for Research Training and Development UK (www.eajournals.org)

FINDINGS

Hypothesis one (1)

To test hypothesis one whether loan decisions will differ when loan accompanying a loan request from when am unaudited report accompany a loan request. The researchers run an ANOVA involving loan decisions based on audited and unaudited Financial Statements. Below is the descriptive statistics. As can be seen from the table below the maximum loan amount that loan officers will grant under both audited and unaudited Financial Statements was 80%. The minimum was 0 % and 5% for unaudited and audited Financial Statements respectively

Table 1: Loan Decisions Descriptive Statistics

	N	Mean	Std. Deviation	Std. Error	95% Confidence Interval for Mean		Minimum	Maximum
					Lower Bound	Upper Bound		
Unaudited	34	40.88	21.932	3.761	33.23	48.53	0	80
Audited	34	54.12	19.751	3.387	47.23	61.01	5	80
Total	68	47.50	21.760	2.639	42.23	52.77	0	80

Table 2: Loan decisions ANOVA

ANOVA: Loan Decisions

	Sum of Squares	Df	Mean Square	F	Sig.
Between Groups	2977.941	1	2977.941	6.837	.011
Within Groups	28747.059	66	435.561		
Total	31725.000	67			

The table above shows the results of one way ANOVA involving loan decisions of loan officers. As can be seen above. As can be seen the F = 6.837 and P = .011 at 5% significant level. We can therefore reject the null hypothesis and conclude that the mean loan granted by loan officers when loan request is accompanied by audited financial statement will differ from loan decision taken when loan request doesn't include an audited Financial Statement. An analysis of the means in table 1 above (audited = 54.12, unaudited = 40.88) indicates that a larger loan will be granted when the loan application includes an audited Financial Statements.

Hypothesis Two (2)

The table below presents the descriptive statistics of hypothesis 2. As can be seen from the table the maximum investment percentage was 90% and 100% when unaudited and audited Financial Statement respectively of the Investee Company is available. However the minimum investment amount that investment officers were willing to make was 0% in cases when the Financial Statements of the company seeking the investment was unaudited and 10% when the Financial Statement was audited.

ISSN 2054-6319 (Print), ISSN 2054-6327(online)

Table 3: Descriptive statistics- Investments Decisions

	N	Mean	Std. Deviation	Std. Error	95% Confidence Interval for Mean		Minimum	Maximum
					Lower Bound	Upper Bound		
Unaudited	34	35.44	21.963	3.767	27.78	43.10	0	90
Audited	34	62.06	22.768	3.905	54.11	70.00	10	100
Total	68	48.75	25.936	3.145	42.47	55.03	0	100

Table 4 below presents the ANOVA results involving investments decisions. From the ANOVA table below F =24.07, P value =0.000 at 5% significance level and hence we can reject the second null hypothesis and conclude that investment decisions differ when the company seeking investment has audited Financial Statement. An analysis of the means (audited = 62.02, unaudited 35.44) in table 3 indicates that a larger investment will be made if the investee has audited Financial Statement

Table 4: ANOVA: Investment Decisions

Investment ANOVA				
Sum of Squares	df	Mean Square	F	Sig.
12044.485	1	12044.485	24.071	.000
33024.265	66	500.368		
45068.750	67			

DISCUSSIONS

The Purpose of this research was to find out whether loan and investment decisions will differ if the loan or investment request was accompanied by audited Financial Statement from loan and on investments amount granted when the when the loan and investment request is not accompanied by audited Financial Statement.. An experiment involving 68 loan and investment officers was performed. We manipulated the presence of audited Financial Statement (Audited Vs unaudited Financial Statement.) Our main findings were that the mean loan amount differ when loan application is accompanied by audited accounts from when loan applications are accompanied by unaudited accounts. We also found that investment decisions when accounts are audited differ from investment decisions taken when accounts are not audited. We observed that the mean loan and investment amount was larger when there was an audited Financial Statements. The findings of this study supports the work of Gómez-Guillamón (2003), Asare & Wright (2009), Gómez-Guillamón (2003) and Kitindi, Magembe & Sethibe (2007) who all found that the standard audit report is useful by both lenders and investotors. However the results of the study +contradicts the work of Libby (1979) who found no evidence that (qualified) audit reports (general uncertainty) affect lending decisions of U.S. loan officers and Moradi et al (2011) there is no information content in (qualified) audit opinion

Implication for Research and Practice

This research has thrown light on the usefulness of audit reports for loans and investment decisions. Thus the findings has several implication for research and practice

ISSN 2054-6319 (Print), ISSN 2054-6327(online)

- Accountants should endeavour to provide timely and objective reports to aid investment and loan decision by the several users of the audited reports
- Financial statement information should represent faithfully what it purports to represents.
- This research has considered the effect of audit reports on loan and investment decisions. The authors only considered audited and an unaudited accounts. However there are several forms of audit opinion.(qualified, unqualified, subject to, except for, and adverse opinion). An Investigation of how these forms of qualification affect investment and loan decisions can be another area of research.

CONCLUSIONS

Financial Statements are considered an important means not only for gauging the performance of the entity but also for understanding how money invested in the entities has been used and enabling those interested in the entity to make pertinent decisions. Auditing Financial Statements add credibility to them. As a results regulators should ensure that the requirement for organisations to provide audited financial statements at regular intervals is enforced to provide investors and lenders with the basis for taking decisions

REFERENCES

Ahmadi, M. R., Sedghiani, B.A & Jamali, K (2010) *Economic Consequences Qualified Audit Opinions: Evidence from listed Companies in Tehran Stock Exchange,* Research Journal of Recent Sciences Vol. 3(10), 89-95, October (2010).

Anvarkhatibi, S, Safashur, M. & Mohammadi, J (2012) *The Effect of Auditors Opinions on Shares Prices and Returns in Tehran Stock Exchange,* Research Journal of Management Sciences Res. J. Management Sci. Vol. 1(1), 23 27, August (2012).

Asare, S. K & Wright (2009) *Investors', Auditors', and Lenders' Understanding of the Message Conveyed By the Standard Audit Report*. www.ssrn.

Bessell, M., Anandarajan, A. and Umar, A. (2003) *Information content, audit reports and going-concern: an Australian study,* Accounting & Finance, 43: 261–282. doi: 10.1111/j.1467-629x.2003.00091.

Firth, M. (1978) *Qualified Audit Reports: Their Impact on Investment Decisions,* The Accounting Review, 53(3), 642–650. Retrieved from http://www.jstor.org/stable/245672.

Gómez-Guillamón, A. D (2003) *The usefulness of the audit report in investment and financing decisions",* Managerial Auditing Journal, Vol. 18 Iss: 6/7, pp.549 – 559.

Guiral, A. & Ruiz, E (2010) *Audit Report Information Content and Auditor Economic Independence in Credit Decisions: An Experimental Investigation.* , The 33rd Annual Congress of the European Accounting Association, Istanbul, 2010.

Hoti, A. H., Ismajli, H., Ahmeti, S. & Dërmaku, A. (2012) *Effects of Audit Opinion on Stock Prices: The case of Croatia and Slovenia.* Euro Economica Issue 2(31)/2012 ISSN: 1582-8859.

Kabajeh, M. A.M., Al Shanti, A. M., Dahmash, F. N & Hardan, A.S (2011) *Informational Content of Auditor's Report and its Impact on Making Decisions from Lenders and Management's View in the Jordanian Industrial Public Firms,* International Journal of Humanities and Social Science Vol. 2 No. 14 Special Issue - July 2012.

Kitindi, E.G., Magembe, B.A.S & Sethibe, A. (2007) *Lending Decision Making and Financial Information: The Usefulness of Corporate Annual Reports to Lenders in Botswan,* The International Journal of Applied Economics and Finance, .1:.55-66.

Moradi, M., Salehi, M., Rigi, M. & Moeinizade, M. (2011) *The effect of qualified audit report on share prices and returns: Evidence of Iran,* African Journal of Business Management. Vol.5 (8), pp. 3354-3360, 18 April 2011.

ISSN 2054-6319 (Print), ISSN 2054-6327(online)

European Journal of Accounting, Auditing and Finance Research
Vol.4, No.4, pp.18-24, April 2016
Published by European Centre for Research Training and Development UK (www.eajournals.org)

Noghondari, A. T & Foong, S. Y (2009) *Audit expectation gap and loan decision performance of bank officers in Iran*, Int. J. Accounting, Auditing and Performance Evaluation, Vol. 5, No. 3, 2009.

Omri, M. A., Errhili, R., & Ghorbel, F.H (2011) *Usefulness of audit report in loan decisions granted by Tunisian banks: an experimental study* International Journal of Critical Accounting (IJCA), Vol. 3, No. 4, 2011.

O'Reilly, D. M (2010) *Do investors perceive the going-concern opinion as useful for pricing stocks?*, Managerial Auditing Journal, Vol. 25 Iss: 1, pp.4 – 16.

Pham, T., Dao, M. & Brown, V. L (2014) Investment *Opportunities and Audit Report Lags: Initial Evidence*, Accounting and Finance Research Vol. 3, No. 4; 2014

Schneider, A. & Church, K. B (2008) *The effect of auditors' internal control opinions on loan decisions*, Journal of Accounting and Public Policy 27 (2008) 1 18

ISSN 2054-6319 (Print), ISSN 2054-6327(online)