



AUDIT RISK ASSESSMENT AND DETECTION OF MISSTATEMENT IN ANNUAL REPORTS FOR AUDIT FIRMS REGISTERED BY REGISTRATION ACCOUNTANTS BOARD (RAB) IN NAIROBI COUNTY, KENYA

Fredrick Mukoma kalui, Lecturer, Egerton university, Department of Accounting and Finance,
P.o.box 536, Egerton. Kenya

Linda .A. Okeyo, Egerton University, Department of Accounting and Finance, P. O. Box
30121, Nairobi. Kenya, okeyolinda@gmail.com

Abstract

Audit risk examines the relevant assertions related to balances, classes of transactions, or disclosures contained in misstatements that could be material to the financial statements when aggregated with misstatements in other balances, classes, or disclosures and the risk that the auditor will not detect such misstatements. With the collapse of Enron involving the misstatement of one of the Big 4, Arthur Andersen & Co. in the US and the CMC and Uchumi scandals in Kenya involving the big audit firms Delloitte and PwC, the argument for audits for big audit firms as synonymous with detection of misstatement has become questionable. Despite several studies having been done on overall misstatement risk none of them has addressed pervasive audit risk. The general objective of the study was to examine audit risk assessment and detection of misstatement in annual reports in audit firms registered by RAB in Nairobi County. The study evaluated four audit risk assessment i.e. inherent risk, control risk, engagement risk and detection risk against detection of misstatement. The study adopted a descriptive research design and targeted all the registered audit firms by RAB in Nairobi county. the study employed systematic random sampling and had a sample of 254 firms. Data was collected from primary sources which involved a well structured questionnaire with an average reliability of 0.86. The data collected from the questionnaire was analyzed using SPSS and a regression model so as to

establish whether the application of audit risk models statistically and significantly affects the detection of misstatement in financial statements. T-statistic was used to determine the significance level whereby the null hypothesis was rejected if it's less than 0.05. A total of 254 questionnaires were administered and 155 were satisfactorily filled and considered for analysis, this formed 78%. The results revealed that the application of audit risk models statistically and significantly affects the detection of misstatement in financial statements. All the four risks tested had a t-test of less than 0.05, thus all the four null hypotheses were rejected. Hence the study concludes that audit risk model reduces the level of fraudulent financial reporting through detection of misstatement in audit practice and relevant recommendations were provided that would enhance the application of audit risk assessment in the audit of financial statement.

Key Words: *inherent risk, control risk, detection risk, engagement risk, material, assertions, misstatemet, audit risk*



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INTRODUCTION

Background to the Study

Adeniji (2004) defined audit risk as the risk that auditors may give an inappropriate opinion on the financial statement. It is the probability that the auditor would draw invalid audit conclusions and therefore express invalid opinion. It is the risk that the auditor may unknowingly fail to appropriately modify the opinion on financial statements that are materially misstated. It is simply seen as the risk that an auditor will issue unqualified opinion on materially misstated financial statements. Therefore audit risk consists of the risk that the relevant assertions related to balances, classes of transactions, or disclosures contain misstatements that could be material to the financial statements when aggregated with misstatements in other balances, classes, or disclosures (inherent risk and control risk) and the risk that the auditor will not detect such misstatements (detection risk). The risk that the auditor is exposed to financial loss or damage to his reputation from litigation, adverse publicity, or other events arising in connection with financial statements audited and reported.

The audit of financial statements consists of evaluating the quality of assertions versus criteria which in the end results in auditors' opinion on the reliability of the financial statements (Amerongen, 2007). The auditor provides reasonable assurance that the financial statements under audit are free from material misstatements. The auditors' opinion on the reliability of the financial statement can be affected by misstatements from errors or fraud. Therefore an effective and efficient audit requires proper assessment of risk and proper allocation of effort subsequent to risk assessment (Blay, et. al., 2003).

Bell et al (2005) stated that the relevance of risk assessment in auditing continues to be emphasized in literature as evidenced by issuance of new risk assessment standards. These standards suggest that a financial statement audit is a recursive process in which auditors make risk assessments related to various management assertions based on evidence. Thus the audit team must plan, collect and evaluate audit evidence in response to assessed risks and aggregate the evidence to form an opinion regarding the fair presentation of financial statements (Gupta, 2005).

The auditing profession is one of uncertainty and high level of business, financial and litigation risk and with the collapse of corporation such as Enron, Tyco International, WorldCom, Global Crossing, BCCI, there has been more stringent process to ensure that auditors exercise due professional care and skill when performing audit assignments. Therefore, the requirement for professional judgment in assessing risk in this uncertain environment is a prerogative to the auditor. Therefore, many studies have been suspicious of the auditors' professional judgmental ability to distinguish audit evidence and proper responses to audit risk (Wustemann, 2004). It is necessary for the auditor to ascertain and assess the nature of risk in the accounting records before giving an audit opinion. The level of uncertainty and risk in the audit environment influences audit strategy establishment and further increase the risk of audit failure. Hence auditors are required to make risk assessment as a basis for designing an audit plan that provides reasonable assurance of detecting misstatements in corporate financial statements (Wright, 2002). Monroe and Ng (2000) view the auditor risk assessment process as a belief revision task, with prior year assessment serving as a starting point. There is currently a plethora and growing body of literature that seeks to examine the nature of audit risk assessment and detection of misstatements in financial statements (Bhinmani et al., 2009). The audit risk model provides the framework for risk assessment. The auditor follows a risk assessment process to identify the

risk of material misstatements in the annual reports of organizations (Gupta, 2005). The risk of material misstatements is made of up of two components of the audit risk model: inherent risk and control risk. The risk of material misstatements is used to ascertain the acceptable level of risk detection and to plan the audit procedure. According to Austen et al (2000), an assumption underlying risk-based audit is that the presence of certain types of risk factors is indicative of possible misstatements in the client's annual reports.

Statement of the Problem

After the case of CMC whereby the external auditor (Deloitte) was accused of misstating the auto dealer accounts, thereby inflating its earnings, there has been a significant effort to improve misstatement detection and prevention in Kenya. The new standards on auditing have been reviewed and improved with emphasis being the use of assertion to link the risks, controls and audit procedures. A resulting benefit being the Auditor will have a better basis for determining the nature, timing and extent of further procedures and assessing potential fraud risk. Several studies have been carried out on audit risk. For instance Eilifsen and Messier (2000) research findings on the association between auditors' assessments of audit risk to detected misstatements are mixed. Kizirian and Sneathen (2003) documented a strong association between overall misstatement risk and the three characteristics of audit evidence using audit file data. However, they did not address pervasive audit risks. This study therefore sought to address this knowledge gap by assessing audit risk assessment and detection of misstatement in annual reports in firms registered by RAB in Nairobi County, Kenya.

General Objectives of the Study

The general objective of the study was to examine the relationship between audit risk assessment and detection of misstatement in annual reports for audit firms registered by RAB in Nairobi County, Kenya.

Specific objectives

- i. To establish the relationship between auditors' assessment of inherent risk factors and detection of misstatement in annual reports for audit firms registered by RAB in Nairobi County, Kenya.
- ii. To determine the effect of auditors' assessment of control risk factors on detection of misstatement in annual reports for audit firms registered by RAB in Nairobi County, Kenya

- iii. To evaluate the effect of auditors' assessment of engagement risk on detection of misstatement in annual reports for audit firms registered by RAB in Nairobi County, Kenya
- iv. To find out the impact of auditors' assessment of detection risk on detection of misstatement in annual reports for audit firms registered by RAB in Nairobi County, Kenya.
- v. To examine the overall relationship between audit risk assessment and detection of misstatement in annual reports for audit firms registered by RAB in Nairobi County, Kenya.

Research Hypothese

Ho1: There is no significant relationship between inherent risk factors and detection of misstatement in annual reports for audit firms registered by RAB in Nairobi County, Kenya.

Ho2: There is no significant relationship between control risk factors and detection of misstatement in annual reports for audit firms registered by RAB in Nairobi County, Kenya.

Ho3: There is no significant relationship between engagement risk factors and detection of misstatement in annual reports for audit firms registered by RAB in Nairobi County, Kenya.

Ho4: There is no significant association between detection risk factors and detection of misstatement in annual reports for audit firms registered by RAB in Nairobi County, Kenya.

Ho5: There is no significant relationship between auditors risk assessment and detection of misstatement in annual reports for audit firms registered by RAB in Nairobi County, Kenya.

Research Methodology

The research design was descriptive survey design. Descriptive studies are usually the best methods for collecting information that will demonstrate relationships and describe the world as it exists. The researcher employed a systematic sample design in which a list of the population was used as a sampling frame and cases were selected by skipping through the list at regular interval. systematic sampling guaranteed the researcher that the population was evenly sampled. The study relied on the use of questionnaires which was used to evaluate their response on relationship of audit risk assessment and detection of misstatement by indicating scores along a 5 point Likert scale ranging from 'strongly disagree' to 'strongly agree. This instrument was used to collect information about the respondents' perception on audit risk factors on the detection of misstatements in annual reports in Nairobi county, Kenya . This type is used to measure perceptions, attitudes, values and behaviour (Mugenda & Mugenda, 1999).

The data collected was analyzed by the use of descriptive statistics. Descriptive statistics describe data on variable numbers. Quantitative data was analyzed using the Statistical Packages

for Social Scientists (SPSS) version 21 which is all-inclusive and offers wide-range data handling capability. A simple regression analysis was used whereby the independent variable was regressed against the dependent variable in order to establish the relationship between the two variables.

The model is presented below:

$$DRaf = \alpha + b1IR + b2CR + b3DR + b4ER + E$$

Where: DRaf = Detection of misstatement

IR = Inherent risk

CR = Control risk

DR = Detection risk

ER = Engagement risk

E = Error

The study sought to test the following null hypothesis:

H0: There is no relationship between audit risk assessment and detection of misstatement in annual reports in Nairobi County. t- test was used to test for significance of each predictor variable (Risk assessment) in the model. The null hypothesis was rejected when the significance value t: statistics is less than 0.05(significance level)

Results and Discussion.

Table 1: Respondents gender

	Frequency	Percentage	Valid Percent
Male	80	52.0	50.0
Female	75	48.0	50.0
Total	155	100.0	100.0

Source: Research Data 2013

The Study findings indicated the uneven distribution of the respondents by gender. There were 155 respondents in total. The distribution is as shown in the figure below, 52% male and 48% female. This implies that gender Equality was almost achieved in the study area.

Table 2: Respondents Age bracket

	Frequency	Percentage	Valid Percent
18-30 years	78	50.0	50.0
30-40 years	39	25.0	25.0
40-50 years	19	12.5	12.5
Above 50 years	19	12.5	12.5
Total	155	100.0	100.0

Source: Research Data 2013

The Study found out that 50% of the respondents were between 18-30 years and they marked to be majority. About 25% of the respondents were of the age between 30-40 years whereas 12.5% each were in the age bracket between 40-50 year and above 50 years respectively. These findings indicate that majority of respondents were young considerably vibrant to understand the new standards on audit risk assessment and detection of misstatements in annual reports; hence most of the external auditors had the prerequisite knowledge of the audit risk assessment factors.

Table 3: Respondents duration in the organization

	Frequency	Percentage	Valid Percent
1-2 years	39	25.0	25.0
2-5 years	78	50.0	50.0
5-10 years	38	25.0	25.0
Total	155	100.0	100.0

Source: Research Data 2013

Fifty percent of the respondents had worked for between 2-5 years while 25% had worked for between 1-2 years and 5-10 years respectively. Working experience in the same organization is an important factor with significant influence on understanding of operations of audit firms as well as clients annual reports thereby understanding the audit risk assessment factors.

Table 4: Respondents years in employment

	Frequency	Percentage	Valid Percent
1-2 years	19	12.5	12.5
2-5 years	58	37.5	37.5
5-10 years	78	50.0	50.0
Total	155	100.0	100.0

Source: Research Data 2013

Majority indicated to have worked for between 5-10 years. The researcher was also interested in determining the distribution of Auditors by experience as measured by number of years in service. Working experience is an important factor with significant influence on understanding of the audit risk assessment factors and detection of misstatements in annual reports.

The Study found out that 50% of the respondents had a working experience of 5-10 years. About 37.5% of the respondent had a working experience of 2-5 years whereas 12.5% had experience between 1-2 years. None of the respondents had a working experience of less than one year meaning the external auditors had a proper understanding of the audit risk factors. These findings

indicate that majority of respondents had worked considerably long to understand audit risk assessment factors and detection of misstatements in annual reports.

Table 5: Descriptive statistics

	N	Minimum	Maximum	Mean	Median	Std. Deviation	Skewness	Kurtosis
Inherent risk	155	32.00	103.00	1.6000	0.7	1.14018	0.139	-0.228
Detection risk	155	41.00	127.00	1.2000	0.71	1.30384	0.678	-0.892
Engagement risk	155	30.00	133.00	1.4000	0.76	1.14018	1.007	-0.984
Control risk	155	73.00	104.00	1.6000	0.74	1.51658	0.74	-0.845
Material misstatement	155	48.00	124.00	1.6000	0.6	1.67332	0.957	-1.266
Valid (listwise)	N 155							

Source: Research Data 2013

Measures of distribution such as skewness and kurtosis indicate how much a distribution varies from a normal distribution. In general, a skewness value greater than one indicates a distribution that differs significantly from normal symmetric distribution.

Inherent risk had a minimum of 32 and a maximum of 103. the average score was 1.600 meaning that inherent risk influences the detection of misstatements in annual reports and the median gap is 0.7. The standard deviation is 1.14018 indicating the spread of gaps away from the mean. The distribution is positively skewed with a skewness of 0.139 which indicates that the figures are deviated more to the right. The kurtosis value is -0.228 which means that the measure of the heaviness of the tails of distribution about the mean is minimal.

Detection risk had a minimum value of 41 and a maximum of 127. The mean is 1.2000 meaning that detection risk influences the detection of misstatement and the median is 0.71. The standard deviation is 1.30384 which means that the gaps are spread away from the mean. The distribution is positively skewed with a value of 0.678 indicating the gaps are deviated to the right of the mean and the gaps are clustered away from the mean with a kurtosis value of -0.892.

Engagement risk has a minimum value of 30 and a maximum of 133. The mean is 1.4000 meaning engagement risk has an impact on the detection of material misstatement and median is 0.76. The standard deviation of engagement risk is 1.14018 which indicates that the gaps are not very widely deviated from the mean. The deviation is to the right with a positive skewness of

1.007. The gaps are also clustered at a point different from the mean of the distribution because the kurtosis value is -0.984.

Control risk has a minimum of 73 and a maximum of 104. The average gap for this dimension is 1.6000 depicting material misstatement. The median gap is 0.74. The standard deviation is 1.51658 showing little deviation from the mean which is spread towards the right as the distribution is positively skewed with a value of 0.74 and the gaps cluster at some point away from the mean with a kurtosis value of- 0.845.

Material misstatement has a minimum value of 48 and a maximum of 124. The average gap score for the material misstatement dimension is 1.6000. The median gap for this distribution is 0.6. It has a standard deviation of 1.67332 which means that the gaps are not deviated away from the mean not. They are deviated to the right because the distribution is positively skewed with a value of 0.9587 and clustered at a value away from the mean with a kurtosis value of -1.266.

Table 6: Relationship between Variables

N=155 Sign. 0.05

	Inherent risk	Detection risk	Engagement risk	Control risk	Material misstatement
Inherent risk	1				
Detection risk	.740 .153	1			
Engagement risk	.731 .161	.942(*) .017	1		
Control risk	.463 .433	.936(*) .019	.839 .076	1	
Material misstatement	.681 .205	.963(**) .009	.891(*) .042	.906(*) .034	1

* Correlation is significant at the 0.05 level (2-tailed).

Source: Research Data 2013

The results established that detection risk and inherent risk were positively related at 0.740 with a significance level of 0.153 this implies that the internal controls systems and the auditor's procedures greatly influence the detection of material misstatement in annual reports. The relationship between detection risk and inherent risk was not significant meaning that the organizations operating results are particularly sensitive to economic factors (such as inflation and interest rates) other than the internal control systems. Engagement risk was positively related to inherent risk at 0.731 p-value and sig. of 0.161 meaning clients business risk and the internal

control system have a positive influence on the detection of misstatement in annual reports though not significant as seen by the significance level, for engagement risk and detection risk they were positively related at 0.942 at sig. 0.017 meaning that the Physical location of the organization's operations makes effective adequate monitoring and a reporting system difficult thus making audit procedures cumbersome and the result is misstatement in annual reports. Control risk and inherent risk were positively related at 0.463 with sig. of 0.433 implying that the relationship between control risk and inherent risk was not significant meaning that the internal control system may not be sufficient enough to detect material misstatement in annual reports . For control risk and detection risk, they were positively related at 0.936 with sig. of 0.019 meaning that auditors procedures influence the detection of material misstatement, for control risk and engagement risk they were positively related at 0.839 with sig. of 0.076 this implied that there is considerable manual intervention required in capturing, processing, and/or summarizing data. .the relationship between material misstatement and inherent risk was a positive relation with a p-value of 0.681 with sig. 0.205 this implied that internal control system have a positive influence on detection of material misstatement but not very significant.detection risk and material misstatement were positively related at 0.963 with sig.of 0.009 meaning that auditors procedures had a significant influence on material misstatement. For material misstatement and engagement risk they were positively related at 0.891 with a sig. of 0.042 again the researcher found out that clients business risk had a significant influence on material misstatement.for material misstatement and control risk they were positively related at 0.906 with sig.of 0.034 meaning that the missing of appropriate controls control has an influence on material misstatement. In general The relationship between all the measurers of variables was found to be significant as for all the variables, the significance level was below 0.05,with the exception of detection and inherent risk, control risk and inherent risk, material misstatement and inherent risk and control risk and engagement risk whose significance value were above 0.05. Further all the measures of variables were positively related to one another as depicted by the positive signs of the Pearson correlations.

Table 7. Regression: Model Summary (b)

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics					Durbin-Watson
					R Square Change	F Change	df1	df2	Sig. F Change	
1	0.462(a)	0.225	0.201	4.719	1.000	3.696	4	0	0.14	1.286

a Predictors: (Constant), Control risk, Inherent risk, Engagement risk, Detection risk

b Dependent Variable: Material misstatement

Source: Research Data 2013

According to the regression summary model (Table 7), the co-efficient of determination (R) indicated a value of 0.462 and $R^2 = 0.225$ or 22.5%. These findings confirm that the observed change in material misstatement attributed to the audit risk factors was 22.5% while the remaining percentage could be explained by other intervening factors such as internal control system, accounting standards and auditors standards.

Effect of audit risk assessment and detection of misstatements in annual report

The researcher sought to test the hypotheses by regressing audit risk assessment against material misstatements where t – test was used to test for the significance of each predictor variables (Audit risk assessment) in the model, the findings are presented in table 4.12 below.

Coefficients(a)

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	6.000	5.380		1.115	0.290
	Inherent risk	-4.000	0.54772	-2.726	0.000	0.024
	Detection risk	12.000	.24495	9.350	-1.633	0.008
	Engagement risk	-2.000	.37417	-1.363	-0.535	0.002
	Control risk	-6.000	0.31623	-5.438	0.000	0.015

a Dependent Variable: Material misstatement

Source: Research Data 2013

The above table, shows the relationship between the dependent variable (detection of misstatement) and the independent variables (inherent risk, control risk, detection risk and engagement risk). In using the regression model $DRaf = \alpha + b1IR + b2CR + b3DR + b4ER + E$

The following regression equation can be formulated from the above study; $DRaf = 6.000 - 4.000 IR - 6.000 CR + 12.000 DR - 2.000 ER + 0.000$. On the basis of the significance values shown on the table above, the independent variables; Inherent risk ($P=0.024$), control risk ($P=0.015$), detection risk ($P=0.008$) and Engagement risk ($P=0.002$). All the four hypotheses were rejected as they had a t-value of below 0.05 significant level, meaning the study established that there is a significant relationship between auditors risk assessment and detection of misstatement in annual reports in Nairobi County.

From the study above, the coefficient for Inherent risk is -4.000 hence for every unit increase in Inherent risk, a -4.000 unit increase in detection of material misstatement is predicted, the coefficients for control risk and detection risk are -6.000 and 12.000 coefficients respectively. This shows that there is -6.000 and 12.000 predicted unit increase detection of material misstatement and for engagement risk is -2.000 meaning that for every unit increase in engagement risk, a -2.000 unit increase in detection of material misstatement. The null hypothesis (i.e. the model lacking explanatory power) was rejected when the significance value t – statistic was less than 0.05 (significance level).

On the basis of the significance values on the above table, audit risk factors namely; inherent risk ($P=0.024$, $p < 0.05$) detection risk ($P=0.008$, $p < 0.05$), engagement risk ($P=0.002$, $p < 0.05$) and control risk ($P=0.015$, $p < 0.05$). This means inherent risk, detection risk, engagement risk and control risk contributed significantly to the material misstatement in annual reports since in all the four factors of audit risk the model lacking explanatory power was rejected since the significance value t-statistic was less than 0.05.

According to the regression summary model, the co-efficient of determination (R) indicated a value of 0.462 and $R^2 = 0.225$ or 22.5%. These findings confirm that the observed change in material misstatement attributed to the audit risk factors was 22.5% while the remaining percentage could be explained by other intervening factors.

Table 8: Overall effect of audit risk assessment and detection of misstatements

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics					Durbin-Watson
					R Square Change	F Change	df1	df2	Sig. F Change	
1	0.462 (a)	0.225	0.201	4.719	1.000	3.696	4	0	0.14	1.286

a Predictors: (Constant), Control risk, Inherent risk, Engagement risk, Detection risk

b Dependent Variable: Material misstatement

Source: Research Data 2013

The Durbin-Watson Statistic was used to test for the presence of serial correlation among the residuals. The value of the Durbin-Watson statistic ranges from 0 to 4. As a general rule of thumb, the residuals are uncorrelated if the Durbin-Watson statistic is approximately 2. A value close to 0 indicates strong positive correlation, while a value of 4 indicates strong negative correlation. Durbin-Watson should be between 1.5 and 2.5 indicating the values are independent (Statistica). The researcher established a Durbin Watson value of 1.286, this implies that the independent variables and the dependent variable were positively correlated in the model. Thus in conclusion the auditors have to put more emphasis on the risk assessment as they highly contribute to their ability to detect material misstatement in the annual reports.

The results of multiple regression analysis obtained multiple correlation coefficient (R) of 0.462 indicates multiple correlations (control risk, inherent risk, engagement risk, detection risk) with the material misstatement. Adjusted R² value of 0.201 indicates the extent of the role of contribution of independent variables is able to explain the dependent variable at the extent of 20.1%. The standard error of the estimate was significant at 4.719

Effect of inherent risk on material misstatement

Ho1: There is no significant relationship between inherent risk factors and detection of misstatement in Nairobi County. The regression for inherent risk against the material misstatement, the t-value was 0.000 which was below the significant level of 0.05, thus the null hypothesis was rejected, this means that the presence of internal control systems was important in detection of misstatement in annual reports.

The study is supported by AICPA (1983) who found out that inherent risks has a significant impact on material misstatement, the findings does not agree with findings of Arens et al. (2005), who established that inherent risks does not affect material misstatement. Similar to Waller (1993) whose results show that as opposed to expectations, there is no important relationship between the assessments of inherent and control risk, which does not support this findings. A study by Buszac and Schmidt (2011) study on detecting misstatements in financial statements revealed that a number factors influencing inherent and control risk have significant impact on the number and size of audit adjustments, which supports the current findings.

Effect of control risk on material misstatement

Ho2: There is no significant relationship between control risk factors and detection of misstatement in Nairobi County. The researcher went ahead to test the control risk against the material misstatement and the t-value was found as 0.000, thus the null hypothesis was rejected, this implies that analysis of appropriate controls, controls done on test basis and inputting of incorrect data contributes significantly to the detection of material misstatement by the auditors.

The findings is supported by AICPA (1983), the study is further supported by Brazel and Agoglia (2007), Wright and Wright (2002), Bulkeley (2006) studies who noted that control risk can also increase as the focus shifts from segregation of duties to greater access to information, supervisory review and supplemental internal control applications. However the study contradicts Arens et al. (2005) findings.

Effect of engagement risk on material misstatement

Ho3: There is no significant relationship between engagement risk factors and detection of material misstatement in Nairobi County. For the engagement risk against material misstatement, the t-value was found as -0.535, the null hypothesis was again rejected for the value was below 0.05, this implies that Physical location of the organization's operations makes effective adequate monitoring and a reporting system difficult and also there are significant and/or unusual related party transactions. Thus analysis of engagement risks by the auditors greatly assists them in detecting material misstatement in the financial reports.

The findings is supported by Mock and Turner (2005) and De Martins (2005) studies who found that overall risk assessments affects detection of material misstatements in the financial reports.

Effect of detection risk on material misstatement

Ho4: There is no significant association between detection risk factors and detection of misstatement in financial reports in Nairobi County. The hypothesis for detection risk against the material misstatement, the t-value was found as -1.633, thus the null hypothesis was rejected as it was below 0.05, and this shows that the organizations operating results are particularly sensitive to economic factors (such as inflation and interest rates) other than the internal control systems and thus the analysis of detection risk clearly helps in detection of material misstatement in the financial reports.

The findings is supported by studies of (Gupta, 2005; Okezie, 2008), who found that detection risk assessments would be influence material misstatements in the financial reports.

Conclusions

The results established that detection risk and inherent risk were positively related at 0.740 with a significance level of 0.153 this implies that the internal controls systems and the auditor's procedures greatly influence the detection of material misstatement in annual reports. The relationship between detection risk and inherent risk was not significant meaning that the the organizations operating results are particularly sensitive to economic factors (such as inflation and interest rates) other than the internal control systems. Engagement risk was positively related to inherent risk at 0.731 p-value and sig. of 0.161 meaning clients business risk and the internal control system have a positive influence on the detection of misstatement in annual reports though not significant as seen by the significance level, for engagement risk and detection risk they were positively related at 0.942 at sig. 0.017 meaning that the Physical location of the organization's operations makes effective adequate monitoring and a reporting system difficult thus making audit procedures cumbersome and the result is misstatement in annual reports. Control risk and inherent risk were positively related at 0.463 with sig. of 0.433 implying that the relationship between control risk and inherent risk was not significant meaning that the internal control system may not be sufficient enough to detect material misstatement in annual reports. For control risk and detection risk, they were positively related at 0.936 with sig. of 0.019 meaning that auditor's procedures influence the detection of material misstatement, for control risk and engagement risk they were positively related at 0.839 with sig. of 0.076 this implied that there is considerable manual intervention required in capturing, processing, and/or

summarizing data. The relationship between material misstatement and inherent risk was a positive relation with a p-value of 0.681 with sig. 0.205 this implied that internal control system have a positive influence on detection of material misstatement but not very significant. detection risk and material misstatement were positively related at 0.963 with sig. of 0.009 meaning that auditors procedures had a significant influence on material misstatement. For material misstatement and engagement risk they were positively related at 0.891 with a sig. of 0.042 again the researcher found out that clients business risk had a significant influence on material misstatement. for material misstatement and control risk they were positively related at 0.906 with sig. of 0.034 meaning that the missing of appropriate controls control has an influence on material misstatement. In general The relationship between all the measurers of variables was found to be significant as for all the variables, the significance level was below 0.05, with the exception of detection and inherent risk, control risk and inherent risk, material misstatement and inherent risk and control risk and engagement risk whose significance value were above 0.05. Further all the measures of variables were positively related to one another as depicted by the positive signs of the Pearson correlations.

According to the regression summary model, the co-efficient of determination (R) indicated a value of 0.462 and $R^2 = 0.225$ or 22.5%. These findings confirm that the observed change in material misstatement attributed to the audit risk factors was 22.5% while the remaining percentage could be explained by other intervening factors such as the internal control system, accounting standard and auditor's standard.

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