

# THE CUMULATIVE EFFECT OF THE LOCAL AUDITOR'S JUDGMENTS

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## Korinko M. D., Manko N. F. The Cumulative Effect of the Local Auditor's Judgments

The article is aimed at studying the influence of the local auditor's judgments on the formation of independent audit thought and building a conceptual model for grouping the results of the local auditor's judgments to form an audit report. The authors analyze interpretations of the concept of «auditor's opinion» by individual scholars and consider expedient a normative fixation of this concept; the basic components on which the professional judgment of auditor is based are allocated and a generalized definition of the given concept is formulated; the stages of audit, which provide auditor with an opportunity to develop a professional judgment are considered together with the factors influencing its developing; the list of decisions, in the process of adoption of which application of a professional judgment is necessitated, is expanded; recommendations on application of individual procedures by auditors in the process of evaluation of the identified distortions of financial statements are proposed; a generalization of the results of the local judgments on separate components of audit process, which are carried out by auditor, is made and the place of professional judgment in the process of assessment of achievement of common audit objectives is defined; a conceptual model of generalization of results of the local auditor's judgments is constructed.

**Keywords:** auditor's opinion, professional judgment, interim conclusions, audit procedures, obtained evidence, audit evaluation, ACI, financial reporting.

**Fig.:** 5. **Tbl.:** 1. **Bibl.:** 19.

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### Коринько М. Д., Манько Н. Ф. Кумулятивний ефект локальних суджень аудитора

Метою статті є дослідження впливу локальних суджень аудитора на формування незалежної аудиторської думки та побудова концептуальної моделі групування результатів локальних суджень аудитора для формування аудиторського звіту. Проведено аналіз тлумачень поняття «думка аудитора» окремими науковцями та визнано за доцільне нормативне закріплення даного поняття; виділено основні складові, на яких базується професійне судження аудитора, та сформовано узагальнене визначення даного поняття; розглянуто етапи аудиту, які надають можливість аудитору сформувати професійне судження та чинники, які мають вплив на його формування; розширено перелік рішень, у процесі прийняття яких зумовлена потреба застосування професійного судження; надано рекомендації щодо застосування аудиторами окремих процедур у процесі оцінки ідентифікованих викривлень фінансової звітності; проведено узагальнення результатів локальних суджень по окремих складових процесу аудиту, які здійснюються аудитором, і визначено місце професійного судження у процесі оцінки стану досягнення загальних цілей аудиту; побудовано концептуальну модель узагальнення результатів локальних суджень аудитора.

**Ключові слова:** думка аудитора, професійне судження, проміжні висновки, аудиторські процедури, отримані докази, аудиторська оцінка, МСА, фінансова звітність.

**Рис.:** 5. **Табл.:** 1. **Бібл.:** 19.

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### Коринько Н. Д., Манько Н. Ф. Кумулятивный эффект локальных суждений аудитора

Целью статьи является исследование влияния локальных суждений аудитора на формирование независимой аудиторской мысли и построение концептуальной модели группировки результатов локальных суждений аудитора для формирования аудиторского отчета. Проведен анализ толкований понятия «мнение аудитора» отдельными учеными и признано целесообразным нормативное закрепление данного понятия; выделены основные составляющие, на которых базируется профессиональное суждение аудитора, и сформировано обобщенное определение данного понятия; рассмотрены этапы аудита, которые предоставляют возможность аудитору сформировать профессиональное суждение, и факторы, влияющие на его формирование; расширен перечень решений, в процессе принятия которых обусловлена необходимость применения профессионального суждения; даны рекомендации по применению аудиторами отдельных процедур в процессе оценки идентифицированных искажений финансовой отчетности; проведено обобщение результатов локальных суждений по отдельным составляющим процесса аудита, которые осуществляются аудитором, и определено место профессионального суждения в процессе оценки состояния достижения общих целей аудита; построена концептуальная модель обобщения результатов локальных суждений аудитора.

**Ключевые слова:** мнение аудитора, профессиональное суждение, промежуточные выводы, аудиторские процедуры, полученные доказательства, аудиторская оценка, МСА, финансовая отчетность.

**Рис.:** 5. **Табл.:** 1. **Библ.:** 19.

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The synthesis document on the results of auditing the financial statements of an enterprise is the report of the independent auditor (referred to as “the auditor” hereafter), which contains the audi-

tor's opinion on the audit results, reflects the answers to the question of whether the financial statements are prepared, in all material aspects, in accordance with an applicable financial reporting framework. The basis for the

auditor's opinion in the report is reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error. The opinion is formed based on the results of assessing individual items, statements, and generalizations, which are reflected in the interim conclusions built upon audit evidence and with regard to the auditor's professional judgment. The auditor's opinion on the form of the conclusion depends on the interim conclusions that have been formed on the basis of the professional judgments of the auditor made by him throughout the performance of the audit engagement. The cumulative professional judgment of the auditor in the form of opinion expressed by him is the result of his work, which is the information base for making decisions by users of the financial statements. That is why studying the process of formation of local judgments and their influence on the formation of the auditor's opinion in preparing the auditor's report on the results of an audit is relevant.

Investigations into the formation of professional judgment in auditing are highlighted by foreign scientists, among whom there are K. Trotman, H. C. Tan, N. Ang [1], A. A. Arens, J. K. Loebbeck [2], Ph. L. DeFliese, H. R. Jaenicke, V. M. O'Reilly, M. B. Hirsch [3], R. Adams [4], and others. Individual issues of the auditor's professional judgment are considered in the works of Russian scientists, namely: M. A. Azarskaya [5], P. P. Baranov [6], E. M. Gutsait [7], T. O. Demidova [8], B. D. Divinskiy [9], S. V. Pankova, E. V. Satalkina [10], T. V. Sinitsyna, O. A. Shaposhnikov [11]. Among domestic scientists who studied the application of auditor's judgment and its structure, O. Yu. Redko is worth mentioning [12]. Changes in auditing standards for professional judgment are covered in the monograph by N. M. Proskurina "Audit procedures. Theory and practice" [13, p. 45]. I. M. Pozharytska, in her monograph "Professional judgment in audit: theory and practice", was the first to elaborate the concept of the auditor's professional judgment at the present stage of development of audit activity [14, p. 82].

According to ISA 200, "the main objective of an audit is to enhance the degree of confidence of intended users in the information contained in the financial statements. This is achieved by expression of an opinion by the auditor on whether the financial statements are prepared, in all material aspects, in accordance with the applicable financial reporting framework".

The objective need for users of financial statements to obtain confirmation of the accuracy of the reporting data, which disclose the character and results of the financial and economic activities of an enterprise, has led to an increased interest in the interpretation of the term "auditor's opinion". This is justified by the fact that it is the auditor's opinion that is an indicator for assessing the reliability of financial statements, which determines the degree of confidence of users in it.

Being an indisputable and unchanging key pillar of an audit report, in the professional lexicon of specialists the concept "auditor's opinion" was formed at the end of the 20th century [2]. In foreign literature, the concept "auditor's opinion" reflects only the definition limited to the general scientific interpretation, without revealing its meaning [15, p. 26].

Since the beginning of the regulation of audit activities, there have been discussions among scholars about the definition of "auditor's opinion". A. A. Arens, J. K. Loebbeck point out that it is "the auditor's conclusions based on the results of the audit conducted by him" [2]. Ph. L. DeFliese, H. R. Jaenicke, V. M. O'Reilly, M. B. Hirsch consider the auditor's opinion as "... a judgment made on the results of the audit" [3]. Russian scientists Ya. V. Sokolov and T. O. Terentyeva, by "auditor's opinion" understand a statement on the quality of the financial reporting verified, which is reflected in the character of the conclusion presented by the auditor [16]. V. A. Erofeeva, V. A. Piskunov, T. A. Bityukova argue that auditor's opinion should be considered as his professional judgment, the subject matter of which is the assessment of what is material [17].

Thus, the interpretations presented by the scientists do not fully reveal the main objectives and significance of the auditor's opinion, which is reflected in the audit report. The statutorization of the concept "auditor's opinion" would greatly facilitate the understanding of the real process and assessment of the auditor's work. The deficit of such information in the audit theory is a problem, since the practice of choosing a form of auditor's opinion reveals unresolved issues and contradictions concerning the correctness of the opinion expressed by the auditor in the auditor's report.

The general scientific meaning of the notion "opinion" is interpreted in the philosophical dictionary as "... one of the most important manifestations of social and individual consciousness, a set of interrelated judgments that contain a hidden or explicit attitude, an assessment of any phenomena, processes, events, or facts of reality" [18, p. 315]. Since an opinion arises in everyday life at the intersection of verity and falsity, therefore, it cannot always be unambiguous [15, p. 39].

According to the current edition of the International Standards on Quality Control, Auditing, Review, Other Assurance and Related Services (referred to as ISA hereafter), all key decisions of the auditor are the prerogative for the implementation of his professional judgment. The absence of legislative and regulatory acts providing clear interpretations and clarifications regarding the concept "auditor's judgment", which is used to form interim conclusions for the auditor's report and the final opinion on financial statements, in a certain way increases the degree of influence of subjective factors on the result of an audit.

The political and economic environment of activities of practicing auditors in Ukraine create certain negative factors in forming professional judgment about the

subject matter of audit, and, accordingly, risks of making inappropriate decisions by the auditor due to the unpredictability of individual events. The conducted procedures, assessment of the quality of the evidence obtained, with reference to the documents formed by the auditor, are the basis of the auditor's professional judgment. It is the completeness of the set of audit procedures, with regard to the experience, level of knowledge, skills, and competencies of the auditor, that ensures the formation of a reasonable reality for "professional judgment" and, accordingly, the performance of the audit engagement.

**T**he definition of the concept "auditor's professional judgment" has an ambiguity in the interpretation of ISA in comparison with individual scientists.

In ISA Glossary of Terms, "professional judgment" is "... the application of relevant training, knowledge and experience in making informed decisions about the courses of action that are appropriate in the circumstances of the audit engagement" [19, p. 51].

A Russian scientist P. P. Baranov considers auditor's judgment as a scientific category that in all its diversity reflects the attitudes of those who prepared the financial statements, users and auditors of the financial statements of an economic entity regarding the reliability of the information presented in it [6, p. 78].

L. A. Yudinseva argues that the quality of the auditor's work depends on his professionalism. The main basis for expressing the auditor's opinion is his judgment about the reliability of the financial statements, which allows users to make correct conclusions about the results of the economic activities, financial and property status of an entity and adopt, based on these conclusions, grounded decisions, and "...the auditor's opinion is an individual form of thinking regarding the reliability of financial statements, which is based on professional judgment and experience" [15, p. 43].

According to I. M. Pozharytska, auditor's professional judgment is "... the process of applying professional competence characteristics in achieving audit objectives under uncertainty to formulate an opinion on professional issues..." [14, p. 77].

R. Adams notes that "... the auditor should be more competent than a client and as smart as he is, as soon as

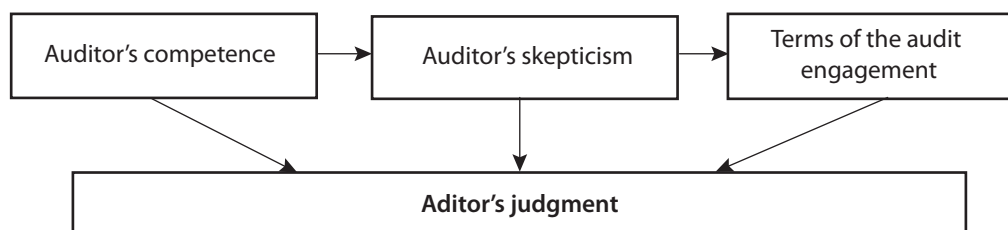
this allows him to understand the client's actions and reveal the content of the studied facts of economic life and psychology of people who committed them, since understanding is, first and foremost, mutual understanding, living into the world of the conflicting interests of those involved in business processes. Indeed, what the auditor sees in the client's reporting is not an objective picture, but the result of the desires of those who prepared these statements and are behind these statements. The auditor should be aware of all this, very clearly understand in whose interests the data of the statement that is verified are formed" [4, p. 97].

Based on the results of the analysis of definitions of the concept "auditor's professional judgment", it is possible to identify the components on which it rests, in particular: scientific category; knowledge, experience, qualifications; tripartite relationship; facts of economic life; auditor's opinion on financial statements; conditions of uncertainty.

**G**iven the above components, it is advisable to form a generalized definition of the concept "auditor's judgment". Auditor's judgment is a scientific category based on the thinking of the auditor as a person, which is the result of knowledge and its generalization; reflects the tripartite relationship among the auditor, the party responsible for the preparation of financial statements and intended users; is formed under conditions of uncertainty concerning the facts of economic life based on the specialist's own knowledge, experience and qualification; is the basis for forming an independent opinion on the compliance of the financial statements with the applicable financial reporting framework. It is necessary to focus on the fact that auditor's judgment is attributed to indicators that characterize the level of experience, knowledge, skills and competences — professionalism.

The factors that influence the formation of professional judgment include:

- ✦ professional competence;
- ✦ professional skepticism (for critical evaluation of audit evidence);
- ✦ terms of the audit engagement (type of engagement: audit of financial statements, review of historical or intermediate financial information, other engagements concerning assurance) (Fig. 1).



**Fig. 1. Factors that influence the auditor's judgment**

Source: developed based on ISA 200 [19, p. 96, 111, 112].

In accordance with the provisions of ISA 200, “Overall objectives of the independent auditor and the conduct of an audit in accordance with the International Standards on Auditing” and ISA 700 “Forming an opinion and reporting on financial statements”, the auditor applies professional judgment throughout the performance of the audit engagement. In view of this, it is advisable to consider the process of formation of the auditor’s judgment by stages of auditing. The stages presented in *Table 1* provide the auditor an opportunity to form professional judgment with regard to the objectives set.

quire applying professional judgment, in particular regarding:

- ✦ acceptance of an engagement to audit;
- ✦ audit sampling;
- ✦ analytical procedures;
- ✦ key audit matters.

The formation of professional judgment necessitates the use of various quantitative and qualitative characteristics. With consideration for the fulfillment of professional tasks, the auditor builds a decision-making process with the application of professional judgment based on the professional competence of the auditor (*Fig. 2*).

**Table 1**

**Stages of forming the auditor’s judgment**

No.	Stages	Judgments
1	Agreeing the terms of audit engagements	About the acceptability or unacceptability of the applicable financial reporting framework. About the availability of all opportunities to complete the audit engagement and provide the auditor’s report. About accepting a new audit client
2	Planning an audit of financial statements	About the degree of materiality and the application of a preliminary assessment of materiality to individual statement items. Regarding the assessment of the risk of material misstatement at the financial statement and assertion level. About the sufficiency of audit procedures performed in response to the assessed risk of material misstatement
3	Conducting substantive testing	About the sufficiency and appropriateness of the obtained audit evidence on the accuracy and completeness of the information in financial statements
4	Completing the audit and reporting	About new or revised risk factors and audit procedures, changes in materiality of the auditor’s report. About identifying key audit matters and the form of audit opinion

**Source:** developed based on ISA 210, 260, 315, 320, 500, 700, 701 [19].

In accordance with the provisions of ISA 200, “Overall objectives of the independent auditor and the conduct of an audit in accordance with the International Standards on Auditing”, the need for professional judgment is considered in the decision-making, in particular regarding:

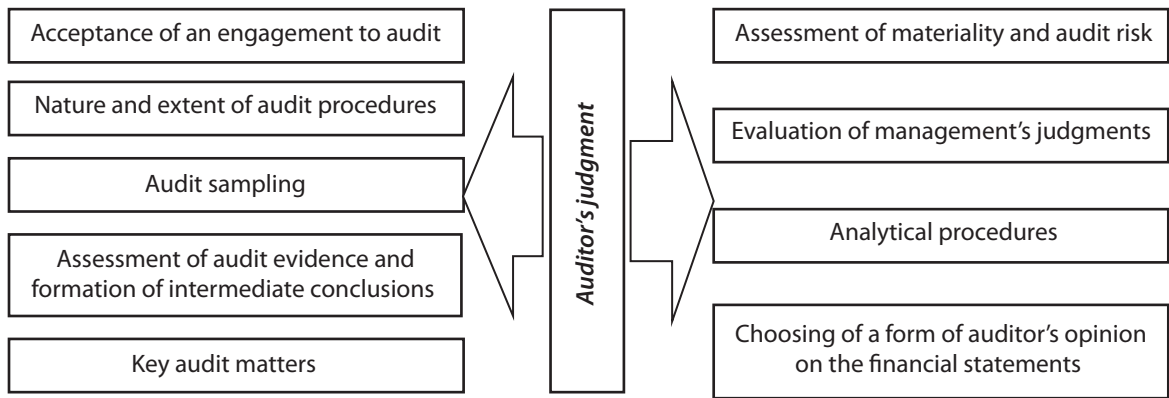
- ✦ materiality and audit risk;
- ✦ nature, timing and extent of audit procedures to gather audit evidence;
- ✦ evaluating whether sufficient appropriate audit evidence has been obtained and whether more needs to be done to achieve the objectives of the ISAs;
- ✦ evaluation of management’s judgments in applying the financial reporting framework;
- ✦ formation of interim conclusions based on the audit evidence obtained, for example: assessment of the adequacy of previous estimates made by management in preparing financial statements [19, p. 112].

According to the results of the study of literary sources and the provisions of the ISAs, there determined the feasibility of expanding the list of decisions that re-

Based on the results of the study, it was found expedient to summarize the results of local judgments on individual components of the financial statement audit conducted by the auditor throughout the period of the engagement, in order to form the auditor’s professional judgment for expressing an independent opinion on the financial statements. Hence, it is possible to conclude that the auditor’s professional judgment about choosing the form of auditor’s opinion to be presented in the report of the independent auditor is the main point of its application. Thus, there is a manifestation of the cumulative effect of local judgments of the auditor.

Taking into account the objectives of the auditor: “... to obtain reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether due to fraud or error, for the auditor to form an opinion about whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework; to issue a report on the financial statements and present information under the ISAs, based on the results obtained by the auditor” [19, p. 98] Establishing whether “the objective





**Fig. 2. Decisions that require applying professional judgment**

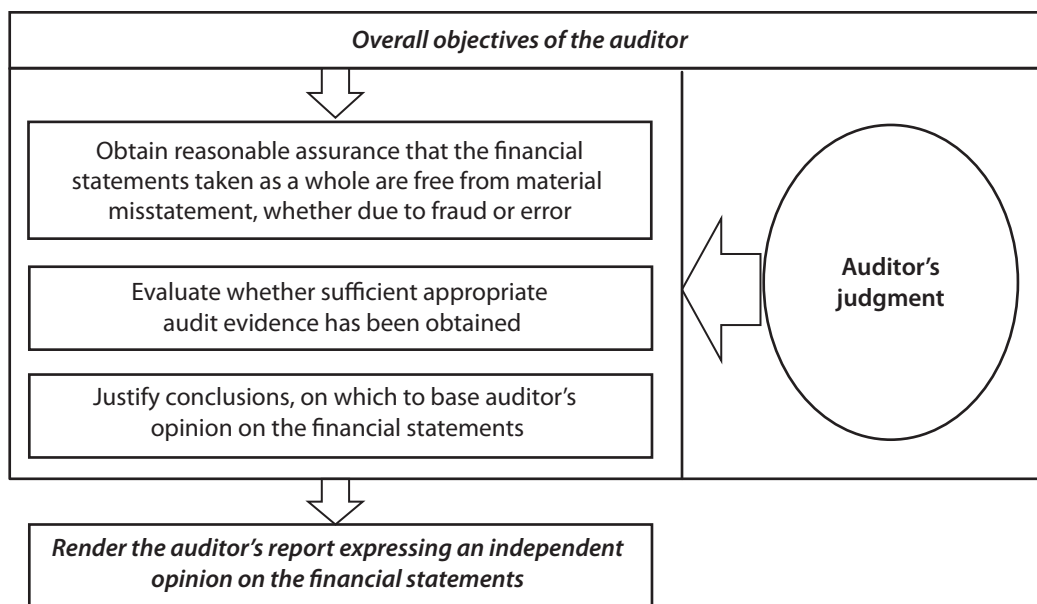
Source: developed based on ISA 200, 210, 520, 530, 700, 701 [19, p. 112, 127, 492, 503, 754, 806].

is achieved” is the result of the judgment of the auditor. The judgment in assessing the state of achievement of an audit objective should be based on:

- ✦ results of the conducted audit procedures;
- ✦ assessed risk of material misstatement;
- ✦ assessment of the sufficiency and appropriateness of the audit evidence obtained;
- ✦ justification of interim conclusions, which after their summarizing and processing will be the basis for the formation of professional judgment in expressing the auditor’s opinion on the financial statements (Fig. 3).

financial statements of an enterprise, on which the opinion is expressed, can contain misstatements that were not detected by the auditor in the course of the engagement, which can result in significant consequences in terms of the accuracy of the financial statements. Accuracy in determining audit risk is a criterion for assessing the quality of the auditor’s work, and its proper justification can serve as an indicator in evaluating his professionalism and competence, since the auditor’s judgment is the basis for measuring audit risk. It is the soundness of the auditor’s judgment that the choice of effective audit procedures, which will be used to reduce audit risk to an acceptably low level, and their extent depend on. The identification of risks of material misstatement necessitates applying by the auditor professional judgment in planning and performing procedures in order to detect fraud or error, both at the level of financial statements and at the level of management’s assertions. Examples of such procedures include:

The components of the audit process include: identification and assessment of risks of material misstatement of the financial statements due to fraud or error that was inadvertently made, both at the level of financial statements and at the level of management’s assertions. Audit risk is a probability that the



**Fig. 3. The place of the auditor’s judgment in evaluating the achievement of the overall objectives of the auditor**

Source: developed based on ISA 200, 500, 700 [19, p. 98, 438, 752].

1) making inquiries of management about assessing by its representatives the level of risk of material misstatement due to fraud; control measures implemented to prevent and detect fraud in the enterprise; identifying specific cases of fraud; actions that have been performed to eliminate the control deficiencies in order to implement measures to prevent cases of fraud;

2) making inquiries of operating personnel involved in the preparation of financial statements, accounting staff, lawyers, senior specialists and other management officials for information about the existence or suspicion of fraud, which, in accordance with the content of ISA 240 "The auditor's responsibilities relating to fraud in an audit of financial statements", which comprises:

- ✦ analysis of responses to inquiries;
- ✦ calculation and analysis of standard deviations of financial indicators;
- ✦ observation, etc.

The formation of professional judgment in selecting by the auditor procedures to assess risks of material misstatement is schematically shown in Fig. 4.

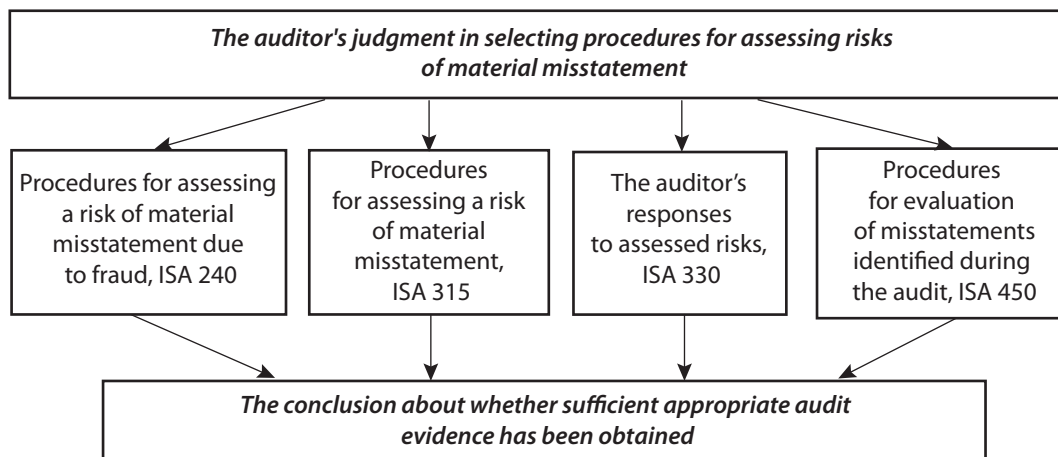


Fig. 4. Scheme of the formation of the auditor's judgment in selecting procedures for assessing risks of material misstatement

Source: developed based on [19].

Risk assessment procedures, in general, do not fully ensure the sufficiency and appropriateness of audit evidence for the auditor to obtain reasonable assurance to form the auditor's opinion on the financial statements. Therefore, in response to assessed risks of material misstatement, the auditor may additionally determine the need for audit procedures and/or tests to evaluate the effectiveness of control measures.

In the course of an audit, it is necessary, based on the information received and processed, to choose an audit methodology that would offer an effective set of audit procedures. It is the auditor's judgment, with consideration for the assessed risk of material misstatement, that allows such a choice of audit procedures. The development of an integrated approach to selecting audit procedures in order to achieve specific audit objectives, which was performed by N. M. Proskurina and published in

her monograph "Audit procedures. Theory and practice" [13], is worthy of attention.

In forming the auditor's opinion and presenting a report on the results of the audit, an analysis of the completeness and reliability of the obtained audit evidence is essential to further assess the elements of a predicted risk of material misstatement. In addition to conclusions about whether sufficient appropriate audit evidence has been obtained, it is advisable for the auditor to assess the compliance of the financial statements with the following criteria:

- ✦ appropriate references in the financial statements to the financial reporting framework adopted by the enterprise;
- ✦ appropriate disclosure of selected and applied accounting policies;
- ✦ compliance of the selected and applied accounting policies with the adopted conceptual framework;
- ✦ adequacy of the disclosure of information on material transactions and events;

- ✦ confirmation that the information given in the financial statements is relevant, reliable, comparable and understandable;
- ✦ presence of signs of possible bias in the judgments of management personnel;
- ✦ reliability of presentation, structure and content of the financial statements;
- ✦ the terminology used in the financial statements is appropriate [19, p. 753].

According to the results of the study, it is advisable to recommend that auditors in the process of evaluating the identified distortions perform certain procedures, in particular:

- ✦ determining the aggregate of specific uncorrected financial statement misstatements, including the results of uncorrected misstatements identified during the previous audit;

- ✦ conducting the auditor's assessment concerning the materiality of the effect of misstatements on the financial statements;
- ✦ informing management personnel about material misstatements detected in the financial statements, requiring that amendments be made to the financial statements.

Refusal of management of the entity to make corrections necessitates assessing by the auditor the effect of the detected uncorrected misstatements on the reliability of the financial statements, in respect of which the conclusion will be formed, and choosing the form of audit opinion (modified or unmodified).

The result of the auditor's judgments, on the basis of which the interim conclusions of the auditor were formed, is used in the process of formation by the auditor of an effective judgment in order to express an opinion of the auditor on the financial statements. That is why the validity and documentary confirmation of the auditor's judgments by the auditor's evidences collected in the process of forming interim (local) conclusions as regards reliability in terms of individual aspects (items, separate components of financial statements) necessitates using a balanced professional approach to summarizing the results of the audit in all essential aspects of entities' activities, which should be reflected in the financial statements. This ensures the auditor's assurance in the absence of material misstatement in the financial statements, whether due to fraud or error.

In view of the practice of audit, to build a conceptual model, there systematized the summarized results of local judgments of the auditor (manifestation of the cumulative effect) in the process of forming the auditor's opinion on the financial statements as a whole (Fig. 5).

Requests from users of financial statements have different goals, which substantiates their requirements to the disclosure of the information they contain, in particular in terms of reliability, relevance, clarity, completeness of the disclosure of certain aspects of the entity's activity. Only taking into account the above requests of users of the information contained in financial statements, the auditor shall make a decision on forming professional judgment about errors, misstatements, inappropriate presentation and / or disclosure of information, which would present an obstacle to meeting such requests, and properly reflect in the auditor's report the necessary qualifications.

The presented results of the research on the auditor's judgment in conducting an audit of certain aspects of entities' activities and financial statements provide an opportunity to address both theoretical and practical issues of forming a reasonable professional opinion of the auditor on the financial status of an enterprise. Accordingly, the above mentioned will increase the confidence of users of financial statements in the indicators they contain to justify management decisions.

## CONCLUSIONS

1. Key decisions are made by the auditor on the basis of the professional judgment formed by him. The auditor's professional judgment and decisions made by him in the course of the audit determine the form of audit opinion on the financial statements.

2. The reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, is the result of the auditor's judgment in forming and summarizing interim conclusions, with consideration for the cumulative effect of local judgments, to express the auditor's opinion on the financial statements.

3. Further research of scientists on the formation and application of the auditor's professional judgment, including: making decisions about accepting the audit engagement, determining the nature and extent of audit procedures, evaluating whether sufficient appropriate audit evidence has been obtained, assessing materiality and audit risk, evaluating management's judgments, identifying key audit matters, choosing the form of the auditor's opinion on the financial statements, will have an impact on the development of the methodological bases of auditing. ■

## LITERATURE

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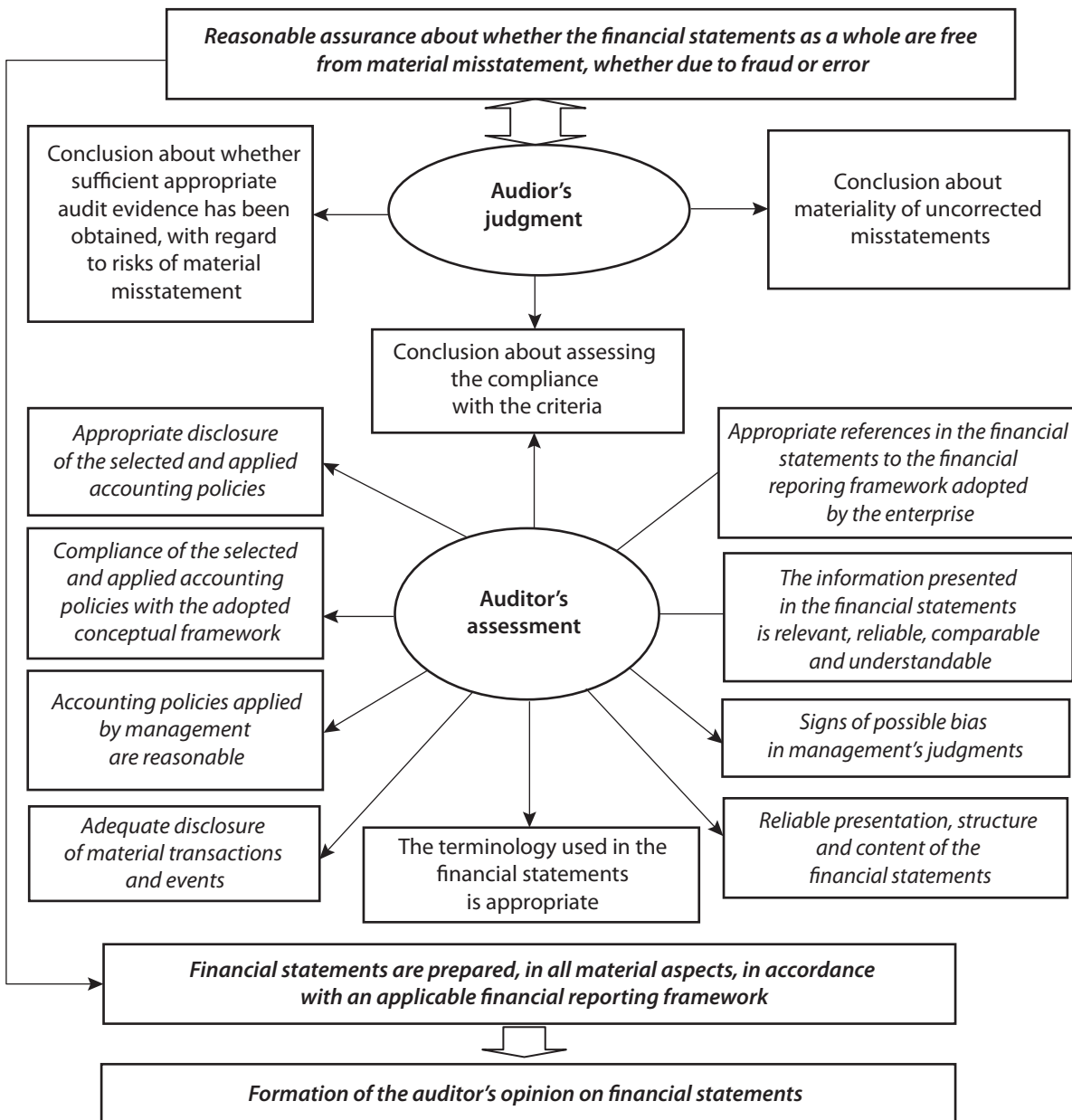


Fig. 5. Conceptual model for summarizing the results of the auditor's local judgments

Source: developed by the authors based on ISA 700 [19, p. 752–753].

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