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Auditor's Documentation vs Auditor's Liability

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Abstract

The demand and supply of audit services had progressed in line with the volume of business transactions necessitating an increase in audit liability. Prior studies have shown that sufficient audit documentation as a reflection of professional duty care and skill is essentially important and capable of enhancing credible and quality audit opinions. Consequently, this study examined auditor's documentation versus auditor's liability. The study adopted an exploratory research approach, using a systematic review of related and useful materials, periodicals, and relevant journals found suitable for the study. The review had shown that the quality and sufficiency of audit documentation is a veritable panacea to support dependable financial statements capable of shrinking and dipping vulnerabilities of auditor's liability. The study recommended that while audit documentation is an indispensable driver of quality audit, documentation alone cannot in itself guarantee the quality of the audit, rather the careful process adopted in preparing sufficient and befitting audit documentation is very germane and this enhances audit quality and credible financial statements.

Keywords: Audit documentation, Auditor's liability, Competence; Duty care, Financial statement,
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1.1 Introduction

Globally, auditing as a discipline is evolving in modifying its roles in auditing practice towards meeting the changing needs of various stakeholders and enhance the credibility of financial statements. Basically, in modern society, auditing is considered as the ability of auditors to provide assurance on reports of the performance of management, whether the financial statement prepared by the management is free of material misstatements or not. The shareholders and the other stakeholders rely on the true and fair representation, for decision making. Consequently, the expectation of shareholders and other financial statement users are credibility and reliability of the financial statement to enhance value creation to decisions made using financial statement, on the contrary, where the revise is the case, both the auditor and the users of faulty financial statement are likely to suffer losses. Aware of audit liability, and other associated consequences of litigations, negative impact of valued reputation on the auditor and the company, auditors strive to avoid professional negligence, rather ensure that professional competence and duty care are carefully observed in carrying their statutory audit function (Annette, Ratzinger-Sakel &Jochen, 2020; Owolabi & Omotilewa, 2020).

Auditors are mindful of possible distortion of facts and records, correspondences, and any other vital information that was collected during the audit exercise in pursuance of professional duty to clients, ensure proper documentation and safekeeping of the working papers (Anna & Melina, 2019). Audit documentation otherwise called audit working papers documentation demand that auditor records procedures performed, the audit evidence obtained and conclusions made based on the evidence obtained, mindful that they may be required for future references (Almulla & Bradbury, 2018; Eric, Rapley, Robertson & Smith, 2018). International Standards on Auditing (ISA 230) states that auditors are expected to document matters which are considered significant in providing audit evidence to support the auditors' expression of opinion and evidence that the audit exercise was actually carried out in accordance with the stipulations of the auditing standards (Hopp, Antons, Kaminski & Salge, 2018). In view of this, auditors, are required to prepare papers which are adequately and sufficiently complete and thoroughly detailed to provide an inclusive understanding of the audit and sufficient information relating to any significant findings or issues that are inconsistent with or contradict the final conclusion (Honigsberg, Rajgopal & Srinivaan, 2019).

1.2 Statement of the Problem

Audit liability and audit failures are general phenomenon and have widened global stakeholders' audit expectations. Nigerian auditors are in any way invulnerable from audit liability. The issue of audit, liability is problematic, complex and a double-edged sword: the high cost of litigation capable of threatening the reputation and sustainability of the audit firms and at the same time (Defond & Zhang, 2014; Honigsberg, Rajgopal & Srinivaan, 2019). Asbahr and Ruhnke (2018) documented that some auditors have suffered huge losses due to poor audit documentation and safety of audit evidence required for audit investigations and court proceedings, and this had resulted in shallow evidence to an ineffective, inefficient and wrong audit judgments. Prior studies have shown that problem of inadequate audit documentation caused a problem for some inexperienced audit firms 'staff suffer greatly for their inability to understand the working paper or previous audit in terms of areas completed, the conclusion is drawn, and the audit professional judgment behind those conclusions (Bliss, Partnoy & Furchtgott, 2018). An adequate and robust documentation is greatly significant for auditors, particularly in the areas of quality control of the audit, exercise prepared that could form a reference documents for others who are not involved with the previous audit exercise to understand the extent of the job performed.

Consequently, the objective of this paper is to review audit documentation versus auditor's liability documentation of auditor's liability. The study proposed to examine the extent of working papers which auditors produce or obtained as the substance for professional judgment, therefore the study considered some basis in assessing the extent of documentation to be prepared or retained, audit evidence of information all accounting data as an input leading to the production of the underlying content of the financial statement is essential to what forms audit liability (Backof, Bowlin & Goodson, 2018; Cade & Hodge, 2014). It is the audit evidence that motivate auditors to draw reasonable conclusions on which to base the auditors' opinion, hence such evidence must be secured and may be useful for the auditors to consider what would be necessary to provide another auditor who has no previous experience of the audit work with an understanding of the work performed and the basis of the major decisions taken (Brown, Majors & Peecher, 216). The other section of the study is structured as follows: Section 2 presented extant literature from the perspectives of conceptual and underpinning theory. In section 3, a methodology was presented and conclusions and recommendations were considered in section 4.

2.0 Literature Review

2.1.1 Auditor's liability

Auditors are duty-bound to express an opinion at the end of each audit exercise and there are audit liability for reckless and any form of incompetence display. In this regards, auditor are equally aware of possibility litigations resulting from incompetence and unethical professional conduct that could have a negative effect on them, dent their image and reputations. For this reason, the auditor will at all time exercise professional care and diligent in the conduct of an audit considering audit litigation, and risk of reputation damaged (Boolaky & Quick, 2016). According to Annette, Ratzinger-Sakel and Jochen (2020), auditing firms and their representatives perform audit exercise and sign the financial statement audited by them. These financial statements ideally represent the audit firm' opinion on the true and fair view or otherwise of the financial statements, the shareholders and other financial statement users ordinarily will believe that the financial statement is credible, reliable, and useful for decision making. The public have high respect and faith that the auditors are transparent, honest, and independent, and as an independent umpire will present an unbiased and reliable financial statement, that will add value to an investment decision because they have faith in the auditors.

Chang-yeol, Kim and Sambock (2020) opined that auditors are not ignorant that shareholders who fire them, and the other financial statement users rely upon their professional competence and fair judgment, aware of this reliance, expectation and statutory obligation, and professional responsibility, auditors will do their work with all due diligence, honesty, and carefully and would not certify what they do not believe to be true, but will take all necessary and reasonable care and skill to perform their audit exercise. Audit liability is prone to occur at the occurrences of any of the following:

i. Situation where the auditors fail to reasonably exercise professional care, competence and skill.
ii. A condition where, as a consequence of negligence and failure to exercise sufficient skill, some material misstatements, fraud or error remain undiscovered and still went ahead to express a credible report of true and fair financial statement.

iii. An unsuspected innocent financial statement user or the shareholders then rely on this assumed unqualified financial statement and make some investment decisions and thereafter suffer some financial losses.

iv. A situation where it has been reasonably confirmed that the financial loss was as a result of reliance on the financial statement, and auditors failure to perform their job properly with all reasonable skill and care.

2.1.2 Types of audit liabilities

The auditor's audit liability could be criminal or civil liabilities. The precise nature and details of auditors' criminal and civil liabilities differ from country to another and largely depend on national legislation of each jurisdiction.

According to Barr-Pulliam, Helen, Brown-Liburd and Sanderson (2017), when the act of professional negligence and incompetence has been established against the auditors, legal claims may follow and in line with the Companies and Allied Matters Act of 1990 as amended and Nigerian Company Law of 2020, these claims against auditors fall into two major categories, the audit firm may be prosecuted under the criminal act, the penalty may either be fine, imprisonment for a guilty or the audit firm may be liable under civil law. Barr-Pullian *et al.,* (2017) noted that when the auditors satisfactorily confirm that they followed the prescribed auditing standards and equally successfully demonstrate these claims in the working papers, the auditors may not be found guilty of professional negligence, confirming the importance of auditors' adequate audit documentations or working papers and ensure they obtain adequate, relevant and reliable evidence to substantiate their audit opinion (Linette & Zehms, 2020; Hopp, Antons, Kaminski & Salge, 2018).

Civil Liability

Under civil liability, legal claims can be made against the auditor when the act of negligence in auditing or professional recklessness is established against the auditor. However, such a claim can be possible upon the establishment of three conditions under the law: one, ability to establish that the auditing firm had a duty of care to the person making the claim based on evidence of loss suffered; two, that the auditing firm or its representatives have broken the duty of care by the auditor's negligence or professional recklessness or that the auditors have not exercised reasonable professional care, justifying that in actual fact, the duty of care was broken Li, Hay and Lau (2018); three, The loss or damage suffered as a result of the breach of the professional duty of care

Liability in Tort: In line with the law of contract, it is only the auditors' clients companies that have the legal right in the law of contract since only the companies have contact with the auditors. In this case, other users of the financial statement have no contact with the auditors, however, where third parties who claim to have suffered losses consequent to auditor's negligence may likely rely on other options in the law under the law of Tort (Abdullatif, Ayat & Rahahleh, 2020). Law of tort is a civil wrong that is not a criminal offense in its content and auditor's negligence when proved is only but one of the forms of tor. Abdullatif *et al.*, (2020) argued that the floodgate of audit liability dispute of guilty is greatly flawed since it must be argued to pass the process of proof in the courts that are ordinary a tedious journey.

Criminal Liability:

Criminal Law: A criminal charges against auditors stand vehemently

i. Where the auditors accept the appointment of audit assignment as professional auditors under statutory provision when in actual fact, the auditors do not have the professional qualification act in that capability;

ii. A situation where auditors have been confirmed to be involved in fraud or falsified accounting records or facilitated in so doing

iii. Where it has been confirmed that auditors were guilty of insider dealings or have facilitated the act.

iv. Use of privilege inside information or knowledge obtaining in course of the audit exercise of price-sensitive for financial gain to the detriment of the clients.

2.1.3 Audit Documentation

ISA 230: International Standards on Auditing made some pronouncements in relation to audit documentation, the standards stipulate that auditors are expected to record in the working papers such information in relation to audit planning, the nature of audit work, audit timing and extent of audit process and procedure performed and possible result or evidence obtained and then the conclusions arrived at from the audit evidence obtained (NSA). The Public Company Accounting Oversight Board (PCAOB) defined audit documentation as a written record of the auditor that provides information guide and support for the auditor's representation and for subsequent reference (PCAOB, 2017). It is expected to contain records to facilitate audit planning, audit performance and audit supervision of engagement, forming the basis of a reference point for auditor judgment and decision for final reporting. PCAOB (2017) stressed that auditors are expected to prepare audit documentation in relation to each engagement carried out by the auditor in pursuance of the standards that will be a written record providing required support for representation in the auditors' report.

According to the standard, in the process of audit documentation, auditors must ensure that audit documentation is relation to each audit, engagement is sufficient and detailed enough to provide clear understanding of the comprehensive work performed to enable principal support for the audit opinion.

Essence of Audit Documentation: An audit documentation is primarily to record and also demonstrate the steps which have been employed by the auditor to help the auditor express an independent opinion on the financial statement audited by them. Audit documentation should provide (i) required in-depth information about the client being audited, line of business, and trend of performance, products or services of the client; (ii) clear evidence of total work performed during the period of the audit exercise; (iii) a clear layout of means of controlling present audit exercise including means of planning future years audit exercise, if given the opportunity; (iv) Proper audit schedule as sustenance of the books and accounts audited by the auditor and possibly the summaries of the client's books and files as presented to the auditors and evidence that the audit was planned and performed in accordance with ISA s and applicable legal and regulatory requirements.

2.1.4 Benefits of Audit Documentations

According to Velte and Issa (2019), a well-drawn up and properly articulated audit documentations is capable of enhancing auditors to derive the following benefits: Firstly, it can enhance systematic and methodical conduct of audit work, since without a proper organized working papers, it may become difficult for auditors to have a full grasp of the full audit work being in orderly and consequential order. Secondly, audit documentation provides good assistance and enhances continuity in a situation where the audit firms' staff have to leave in the middle of the audit exercise. Some experience has shown that some auditor staff may resign his or her employment, fall sick or any act of nature forcing the auditor to stop before the end of a particular audit exercise, with proper audit documentation or working paper, it becomes impossible to know the extent of the job so far done, otherwise, the audit will commence afresh. Thirdly, Audit documentation will facilitate an independent review of audit exercise so far done, as expected, the reviewer does not need to be present at the client's office when the audit exercise was carried out, but with good audit documentation of a working paper, the reviewer can carry out an effective audit review.

Fourthly, Audit documentation is a vital tool to support auditor to express an audit opinion. Basically an audit opinion is based on well-articulated and documented dialed work done, documentation of a job done and observation right from day one spanning to the entire audit exercise. Fifthly, audit documentation eventually serve as a permanent record of tests and procedures followed during a particular audit exercise for future references. Temporary rough papers used may eventually get missing if good documentation was carried out. Sixthly, proper audit documentation could provide a good guide in terms of planning future audit exercise, and possibly audit engagements. The auditors may decide to make reference to previous documented working papers and procedures as a guide for current audit exercise. Seventhly, audit documentation is very vital and will later serve as a useful source of evidence in events of litigations against auditor (Carver & Trinkle, 2017; Cade & Hodge, 2014).

2.1.5 Nature and Contents of Audit Documentation

Sneller, Bode & Klerx (2017) noted that Audit documentation is usually done using two basic files of the current audit file and permanent audit file.

Current audit documentation: Brown, Majors and Peecher (2016) stated that current audit documentation contains audit information that is useful and relevant to the auditor for a period of one year. In most cases, this current audit file form source of auditors' judgment and expression of opinion of the client's financial statement. The current audit documentation is expected to hold the following: (i) a copy of the financial statement and the trial balance prepared by the client's management which the auditors are auditing; (ii) A copy of the audit program containing a full list and details of audit work auditor want to do, and possible audits that needed to be performed; (iii) the paper containing a schedule of basic items expected to be in the prepared statement of profit or loss and other comprehensive income, and statement of financial positions of the client Furthermore, Brown *et al.*, (2016) stressed that this includes: (iv) a list of issued audit queries and answers obtained from clients staff or from the internal auditor; (v) a copy of important matters that may require the attention of the audit partner's immediate attention; (vi) an extract of the minutes of meetings of the board of directors and management; (vii) a copy of details of internal control systems and control measure in operation in the company (viii) a copy of letters of representation from the company management; (ix) a copy of the checklist of evidence of compliance to industry-related statutory disclosure requirement and that of accounting standards employed in the preparation of the financial statements; and also (x) a copy of management letter that states out in details internal control weakness of the client as observed by the auditor.

Permanent Audit Documentation: According to Asbahr and Ruhnke (2018), every audit documentation must consider some files that are expected to last beyond the current year of audit. This file is expected to contain important information that requires permanent for a retention of audit paper for as long it is safe, however, at least a minimum period of 7 years as prescribed for audit working papers. This is expected to contain the following: (i) a short background and details of the client and business in terms of the client's nature of business, products or services, and known major competitors; (ii) a copy of accounting principles in use, such as depreciation rate and dividend policies of the company; (iii) list of prescribed status and other applicable rules and regulation governing the operation of the accounting and auditing units of the company; (iv) list of full names, and current addresses of board of directors; (v) a copy of memorandum and articles of association forming the basis of the company line of business operation; (vi) a copy of the company organization organogram stating structure and line of reporting; (vii) list and addresses of outside branches of the company; (viii) list of partners, subsidiaries, and franchises if any; (ix) a copy containing a list of books, records, non-current assets schedule, and where they are.

2.1.5 Retention of Audit Documentation

Retention period: ISA 230 audit documentation, auditors are required to retain audit documentation for a period not less than seven (7 years) from the period and date that the auditor has given consent to use the audit report in relation to the issuance of the clients financial statement otherwise the date of report release, however the longer period of retention can be adjudicated by any jurisdictional discretion but not less than 7 years. More so, the standard stipulated that where a report of retention is not issues in relation to engagement, then the audit documentation should be retained for at least a period of 7 years from the time and period that audit fieldwork was deemed to have been substantially completed. The standards stated that before a report release date, auditors are expected to have finished everything in relation to audit exercise and must have obtained appropriate and sufficient evidence that will guide and support the representation in the auditor's financial statement reporting (Almulla & Bradbury, 2018; PCAOB, 2017)

Documentation Completion Date: The standards stated that a completed and auditor's final set of audit documentation must be assembled for audit documentation retention for a date not more than 45 days after the financial statement release date. This must be a time and period the auditor must have ended and substantially completed all forms of audit fieldwork (PCAOB, 2017).

2.1.6 Audit documentation and Storage

The world is fast evolving as speed and the volume of a business transaction is enormous, that manual documentation is becoming near impossible. New innovations and disruptive technologies are creating data storage easier and safer. According to Patel and Patel (2019), the data and information storage landscape keep improving to enhance audit documentation and storage. The movement from all-flash storage to new cloud storage is making audit documentation efficient and secured. Research has revealed that the new cloud computing has influence data and information storage technologies such as Microsoft Azure Storage, and Google Cloud storage. Others include High-density flash storage media, Non-volatile memory express protocol, embedded memory technologies for artificial intelligence, and Internet of Things (IoT) (Patel & Patel, 2019; Sneller, Bode & Klerx, 2017).

Cloud accounting storage: Eickhoff, Muntermann and Weinrich (2018), stressed that Google cloud storage has completely revolutionized how information technologies and audit firms operate and handle information storage. As a disruptive technology, cloud computing and storage facility have replaced hardware and other manual audit documentation and storage, with more reliant and robust large-scale servers as opposed to more local options.

Internet of Things: According to Kaya and Akbulut (2018), in the world of information technology and audit documentation exercise is increasing in volumes and heaps beyond what no-reliable flash drives can handle. The volume of records and working papers are growing that new technologies are easing storage challenges. What might seem like a futuristic practice is quite real and ever-present in a larger volume of storage in audit firms and financial accounting services (Patel & Patel, 2016).

2.2 Underpinning Theory

2.2.1 Contingency Theory of Audit: Auditors are mindful of audit liability, since in course of the audit exercise, when things get unpleasantly bad, there is a possibility of audit litigation, hence the relevance contingency theory of audit as an underpinning theory of this study. It is believed that the primary aim of audit services is to add value to financial statement users' decisions made using financial statements. However, when the information contents turn to be false and contained material misstatements, that had misled innocent users, cases of unpleasant litigation could surface (Barney, 1996). Contingency theory was developed by Joan Woodward in the year 1958. The theory noted that the primary duty of corporate managers or leaders is to make decisions that are not detrimental to the going concern of the organization or have a negative effect on the company. The theory further suggested that corporate bodies and management should at all times be careful to analyze the possible outcome and effects of their decisions and ensure that such decisions or policies will not lead the company into unnecessary litigation, stating that every decision of the auditor in pursuance of auditor's opinion should be weighed (Barney & Clark, 2007). Therefore, a thorough audit exercise and professional care and skill must be the auditor's watchwords.

Alvarez and Busenitz (2001) opined that a good audit documentation could be consulted by the auditors in cases of litigations as evidence if the auditor had methodically followed the audit standards in course of the audit exercise, shareholders and other concerned financial statement users deserve the facts and true position of this information to guide them in making useful decisions. Auditors are required to disclose every financial and non-financial information and accurate information regarding management policies that are capable of affecting the financial statement position of the companies (Barney and Clark 27).

Barney, Ketchen Jr, and Wrights (2011) stated that contingency theory of audit is appropriate in the audit-related situation since management and the auditors now know implications and potential repercussions of corporate actions and decisions, hence they must be very meticulous and verify every information disclosure. Ebrahim and Rangan (2003) posited that concealment, or misrepresentations by the auditors and any other person is unacceptable, hence it is the duty of auditors to advise the client to correct these wrongs since they may affect the financial statement and moreover, these actions could expose the company running to problems. The general public expects the auditors to take these factor into consideration during the audit exercise, believing that every audited financial statement is free from misleading information and also, probable future events not known or explained in the financial statement capable of hunting their investment decisions made from the financial statements (Fiedler, 1964).

There are some assumptions of contingency theory of the audit that management has no specific standard method which the organizational decision must be made, controlled, or management, however, whichever method adopted by the management, the managers must be considered legal and future exigencies implications, that the cost of litigations and the negative outcome from pending litigations could be devastating and affect the health status of the information on the financial statement. Lundstrom and Stevenson (2006) stressed that managers should be transparent enough as required under the corporate governance best practices, disclose such information to the knowledge of the users of such non-financial issues and that the auditor is expected to exercise professional competence and not compromise public trust on them, and disclose such information in the audited financial statement.

2.2.2 Lending Credibility Theory: Relevance as an underpinning theory is lending credibility theory. Audit liability is heightened when there are sufficient auditing documentation is lacking and the consequent absence of duty care and skill. Adding value to financial statement users is enriched when an audit report is credible and capable of boosting stakeholders' confidence (Nunnally, 1978). Lending credibility theory suggested that adding credibility is an invaluable expectation from the public. In other words, the lending credibility theory posited that a financial statement is absolutely void and insignificantly valueless if credibility is lacking. The theory posited that credibility enhances users' confidence in using the financial statements, it is capable of adding value to investment decisions and that reliability of financial statements is a virtue that every audited financial statements should possess (Parsons, 1956; Singh & Rani, 2009). Furthermore, since the financial statement is prepared by the management, the shareholders, and other interested stakeholders would want a third party who is an independent umpire to verify and certify the truism and factual facts of the contents and reliability of the accounting numbers as contained in the financial statements of financial position and statement of profit or loss accounts and others as presented by the management. Consequently, if stakeholders such as investors, government, creditor, must make an economic decision based on the financial statement prepared by the managers who manage the affairs of the company, they do so based on the credibility of financial statements (Wilson, Kickul & Marlino, 2007).

Carman (2010) posited that exercising professional duty care adds credibility to financial statement and at the same time reduce information asymmetry created by the separation of ownership and management, resulting in possible bias and conflict of interest, especially where managers often times are seen to be opportunistic in their action since they have privilege information that the other stakeholders do not have, as such they can use it to pursue their own interest to the detriment of the shareholders and other stakeholders. The demand and supply of audit services in recent times has gone to the point that a joint audit is required to enhance more credibility and lend credence to the financial statements. Consequently, this theory is considered relevant to audit liability and use as a building block for sufficient and well-articulated audit documentation, towards reducing auditor liability.

3.0 Methodology

A review of audit documentation versus auditor' liability documentation of auditor' liability was carried out in this study. Adopting an exploratory research approach, a systematic review was explored considering related useful materials, periodicals and relevant journal found useful for the study.

4.0 Conclusion and Recommendations

Conclusion: Audit exercise requires gathering relevant and reliable audit evidence to enable auditor expression of an opinion on the books and accounts presented to validate or otherwise the financial statement presented to the auditor. In carrying out this exercise, the auditor must be aware of audit liability and possible litigation. The onus is on the auditor to provide enough and sufficient audit documentation to enhance the quality and credibility of the audit report. The review had shown that the quality and sufficiency of audit documentation is a veritable panacea to support a dependable financial statement capable of adding value to investment decisions. The study examined Audit documentation versus auditor's liability, documentation on auditor's liability. The study revealed that audit documentation is expedient and supporting evidence to enhance superiority expression of opinion.

Recommendations: Auditors must exercise all professional duty of care considered reasonable in all circumstances while carrying out an audit services, this is one of the safety precautions available to the auditors considering the obvious audit liability. While there is no formal and precise format prescribed by the audit standards for audit documentation, auditors should ensure that working papers conform to the peculiarity of audit requirements of particular audit firms that will guarantee the requirement of an independent auditor. Considering the cost implication and reputation damage of associated with audit liability, professional competence and duty care should be exercised in audit documentation and in the expression of opinion by the auditors. While audit documentation is an indispensable driver of quality audit, documentation alone cannot in itself guarantee the quality of the audit, rather the careful process adopted in preparing sufficient and befitting audit documentation is very germane and enhances audit quality and reliable financial statements.

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