

The Importance of Audit Procedure in Collecting Audit Evidence/ Case of Kurdistan Region/ Iraq

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Abstract: This research mainly focused on the external auditors' responsibilities in Kurdistan regarding the audit procedure and it's important to collect evidence which consider the willingness of the companies to run from tax. I interviewed two professional individuals in the Directorate of Financial Supervision Office who are auditing both governmental organizations and private sectors in Kurdistan region. I asked them whether they have an efficient audit procedure in order to collect sufficient and appropriate audit evidence in order to prevent any running from taxes by the companies. The purpose of this research is to persuade the companies and external auditors that the external auditor can play a significant role in recommending and preventing the companies to not run from tax.

Keywords: External Auditor, Audit Evidence, Audit Procedure

1. Introduction

Since Kurdistan Region Government is facing financial crisis, there are a lot of companies are running from taxes and even before the financial crisis it was the same. For this purpose I decided to interview some professional people in the accounting and finance field to reach their opinion about this issue. Depending on the international laws one of the external auditors' responsibilities is giving his/her opinion about true and fair view of the company's financial statements in his/her report after reviewing the financial statements of the companies. In order to make sure that the companies' financial statements are providing true and fair view, the external auditors have to collect sufficient and appropriate audit evidence through audit procedure (Porter, Simon & Hatherly, 2008; Noori & Rashid, 2017). Companies will achieve advices, recommendations, notifications and awareness from professional people for giving a percentage of their profit as a tax to the government because after the financial crisis the government is willing to discover a different way of funds instead of depending only on the natural resources and in particular oil resources. Likewise, external auditing are performing in Kurdistan but not efficiently regarding running from tax. However, this might be because of the companies' accountants that they are working for the benefit of their companies. They do not demonstrate the real profit of their companies in their financial statements in order not to give their share of profit to the government as a tax. This might

be due to the lack of trust between companies and government because; they believe that the government is not utilizing taxes payment to serve the society. Instead, some of the companies are conducting some of the governments' duty especially the service one. They are working in providing roads, gardens, schools, water and so on (Posner, 2000). Thus, as an attempt to challenge this financial crisis the external auditor's responsibilities should be persuading companies not to run from tax in order to help the government to pass this financial crisis with the lowest losses in terms of serving society (Posner, 2000).

2. Methodology

The research makes an attempt in finding out whether there is any way to persuade companies not to run from tax. Hence, it would be logical enough for the research methodology to question external auditors in Kurdistan. This would enable critical examination of all various factors and risks that may be faced by companies in Kurdistan. The investigation will allow understanding of the manager's perception. This could offer important insights into the scope of this research.

2.1 Significance of the Study

One of the primary responsibilities of auditors in the world, is to form and express an opinion whether or not their audit clients financial statements provide a true and fair view of their entity's financial position and performance (Noori & Rashid, 2017). In order to form this opinion, auditors must gather and evaluate sufficient appropriate audit evidence, which can be collected through audit process therefore, it is important for the auditors to collect evidence in order to know whether financial statement of a company provides true and fair view or not (Noori & Rashid, 2017), because if the company's financial statements provide true and fair view this will improve that the company cannot run from tax.

2.2 Research problem

Most of the companies in Kurdistan are running from tax due to the lack of trust of the government as a consequence of the political and financial crisis in Kurdistan. Therefore, it is the auditors' responsibility to discover the real profit of the company, in order not to let company to run from tax. This will be controlled by collecting sufficient and appropriate audit evidence through audit process (Porter et al, 2008).

2.3 Research Hypothesis

My hypothesis is that, most of the companies in Kurdistan are not willing to pay tax to the government. Therefore, they will manipulate the financial statements.

1.4 Research Sample

I am selecting the Directorate of Financial Supervision office in Kurdistan.

3. Literature Review

3.1 Audit Evidence

Auditors can accumulate audit evidence through audit process in order to meet specific audit objectives and thereby reporting about the related general audit objectives. Consequently, they can achieve sufficient appropriate audit evidence to support their opinion about the financial statements; whether they provide true and fair view of the company's financial position and performance, and whether they comply with the applicable financial reporting framework such as: IAS or UK GAAP or not (Moeckel, & Plumlee, 1989).

International Standard on Auditing (ISA) 200 explained the importance of auditors accumulating sufficient and appropriate audit evidence: "overall objectives of the independent auditor and the conduct of an audit in accordance with international standards on auditing." (Porter et al, 2008, p.257). It is clear from the above statement that the overall auditor's objective is to obtain reasonable assurance about the financial statements whether they are materiality misstated or not. Reasonable assurance can be obtained by the auditors when they could achieve sufficient appropriate audit evidence in order to reduce audit risk to the accepted low level. Sometimes this risk will be raised when the auditor expressed an inappropriate opinion about the financial statements that were materiality misstated (Porter et al, 2008; Salterio & Koonce, 1997).

According to Porter et al (2008) sufficiency means the number of evidence, in another word the quantity of evidence. Appropriateness means relevant and reliability. Generally, the auditors may examine only part of the available evidence. Different types and different sources of evidence might be selected. There are a number of factors which can be taken in to consideration in order to decide which evidence has to be collected (Porter et al, 2008; Salterio & Koonce, 1997; Tan, 1995). The first factor is *Relevance* of evidence, which means the evidence is closely related to a specific objective that the auditor is attempting to achieve. The second one is *Reliability* of evidence, which means the evidence reflects the matter which is being investigated, in another meaning the evidence is more reliable when it is obtained by auditor personally, or obtained by independent sources outside rather than by inside the company. Hence, original documents are more reliable than photocopies. However, in internally generated evidence, the internal controls should be operated effectively. Another factor is *Availability* of evidence (Porter et al, 2008; Tan, 1995). This factor refers to auditor's readily about evidence's acquisition. *Timeliness* of evidence is another factor of deciding which evidence should be collected which refers to obtaining evidence quickly. In some particular circumstances, if the auditors need to access to the client's accounting records and some information ready after three months probably, here, the auditors should rely on estimated amount instead of waiting for nearly three months, because the auditor's report should be completed on a timely basis (Porter et al, 2008). The last factor is *Cost* of evidence. The auditor should make sure that obtaining a particular evidence will provide benefits for them in forming an opinion about whether the financial statements are fairly stated or not, or the internal control have been complied with or not (Porter et al, 2008; Tan, 1995).

3.2 Audit Procedures

Audit procedure is a method utilized to collect audit evidence. Audit test or audit technique is used interchangeably (Porter et al, 2008). ISA 500: audit evidence characterizes seven audit procedures which will be explained as follows: (Porter et al, 2008).

- 1) Inspection: internal or external records or documents will be examined in this test in a form of paper, electronic or other media or in case of inspecting an asset, physical examination will be used as well. Demonstrating the vary degree of reliability will be providing by the inspection of records and documents, which depends on their nature and source. (Para A14) specified for the test of controls by inspecting the records for the evidence of authorization. An existence of an asset means having direct evidence (Gonzalo & Gallizo, 1992; Martinez, 2001). Although, inspecting in such documents does not necessarily provide audit evidence about ownership (Para A15). Providing reliable audit evidence by inspecting intangible assets does not improve the company's rights and obligations or even the valuation of the assets (Para A16).
- 2) Observation: means checking the procedure which is being performed by others. This technique is providing audit evidence with respect to the performance of the procedure. However, this evidence is limited due to the time of conducting the observation (Para A17) (Porter et al, 2008; Beasley, Carcello, & Hermanson, 2001).
- 3) External Confirmation: sometimes the audit evidence which are obtained by external auditor need to be confirmed by the third party. This confirmation can be in a paper form, or electronic form, or other medium (Porter et al, 2008). For instance, communicating with debtors when the auditors are looking for direct communication of receivables. Sometimes auditors require the confirmation about agreements or transactions which the company has with the third party. They may ask for any modifications which have been made to the agreement. Hence, this test is used to obtain audit evidence about "side agreement". This agreement will be signed between audited entity and customer for repurchasing a significant item at a profit to the customer, when customer cannot sell it in a specific period (Para A18) (Porter et al, 2008; Collis, Jarvis & Skerratt, 2017).
- 4) Recalculation: mathematical accuracy of documents needs to be checked which can be performed electronically or manually (Para A19) (Porter et al, 2008; Hoffman, & Zimbelman, 2009).
- 5) Re-performance: implementing a procedure by the auditors independently was originally performed by internal controller (Para A20) (Porter et al, 2008; Cangemi, & Singleton, 1996).
- 6) Analytical Procedures: this technique involves evaluating financial information in the financial statements. For instance, evaluating profitability or liquidity of the company by comparing 5 years financial information in the financial statements (Para A21) (Porter et al, 2008; Janvrin, Bierstaker, & Lowe, 2009).
- 7) Inquiry: this test is looking for information from financial or nonfinancial knowledgeable persons whether inside or outside the company. This can be formed as a formal written inquiry or as informal oral inquiries, and the responses of this test should be evaluating (Para A22) (Porter et al, 2008; Raghunathan, 1991).

4. Interviews and Findings

4.1. Interview

- 1- As an external auditor, how evidence is important?
 - Without concrete evidence no work will be done.
- 2- What does evidence mean for you?

- Evidence is everything for us.
- 3- How the evidences will be collected and depending on which procedure?
 - When we have doubt of any place we will start to collect evidence on it through our committee
- 4- As an external auditor will you review both public sector and private sector, or just public sector?
 - both public and private sector.
- 5- Which department do you audit? Only accounting and auditing department or all the departments of the unit?
 - We are auditing all sectors, anything we have doubt it.
- 6- Audit evidence consists of 7 audit procedures in the world, do you have these procedures or not?
 - Yes, we have all this procedures.
- 7- When you are going to a private sector, do you work with your staff or a private sector employee?
 - When we are going to a private sector, we have professional staff to work with us.
- 8- Depending on which basis do you choose your staff?
 - We are choosing our staff depending on experience, skills and qualification.
- 9- Do you copy the evidences or not?
 - Yes we will copy all the evidences and we will keep them in a private box file.
- 10- Do you have a specific time to go to any private sector? Or when you have doubt about somewhere to go?
 - Yes we collect all evidences and we have annual agenda.
- 11- When you are going to the private sector, do you have a specific room to save evidence over there? Because, maybe this procedure needs more than one day?
 - Yes, they provide as a room and we save all the documents over there we keep the key of the room with us until we finish our duty.
- 12- At the end of your work, do you copy the documents and attached with your reports or not?
 - Yes, we copy and keep them in planning department.
- 13- To whom you are reporting?
 - One copy for us and another copy for parliament.
- 14- Who can take advantages from your reports?
 - Government and specific public sector.
- 15- Is it necessary for external auditor to mention the evidences that has been used in their reports?
 - Yes, it is necessary.
- 16- Did you face any problems during the search for evidences?
 - Yes, but very rarely.
- 17- To what extent the place that you are working is helpful for you to provide documents?
 - Sometimes we face a problem, but generally they are helpful.
- 18- When there hiding the truth?
 - No, they cannot, because we became a part of parliament.
- 19- Do you have authority to overcome?
 - Yes, we can overcome all.
- 20- To what extend the low is cooperate with you to manage your duties?
 - Yes, they are helpful generally.

5. Findings

Obviously, from the interviews, the governmental organizations and companies are auditing by different type of external auditor who are working in the same office. The first one is auditing by the directorate of financial supervision office which is checking the whole business such as: accounting, management, inventory, and so on. The second one is also auditing by the directorate of financial supervision office that is only reviewing the whole business as well. They are using the same audit procedures that are adopted internationally. They are collecting and keeping all the documents that they achieved. They will have a room in a particular organization until they will finish their duty. Through the interview, it is obvious that the external auditors are going to the organizations to review their work annually and they have their own staff to conduct this duty. Hence, they will keep a copy of their evidences that they collected in their report and they have authority to call for any evidences they want because they became a part of Parliament. Another finding could be that the external auditors are reviewing every work in the companies and they can collect evidence easily as they have mentioned in the interview, so here the question is that *how the companies can run from tax?* This means the companies' accountants might have a role in hiding information about the companies' real profit. Another finding is that the companies are not so pleased with the external auditor because, they believe that having external auditor means criticizing and charging them. The reason might be that there is no cooperation between the companies and external auditors. Another finding is that they are only reviewing and checking the companies' financial statements and this can be conducted by internal auditors. If external auditors advise companies and government offices to improve their financial resources, they will absolutely change their thinking about external auditors. The role of external auditor has been simplified in this country by only reviewing financial statements. This is an internal auditor's duty and this duty is conducting permanently. There is no matter to do it again by the external auditor.

6. Conclusion and Suggestions

In conclusion, it is clear that the external auditing in Kurdistan is performing efficiently, because they are collecting evidence from all the companies according to law. Although, there is no increasing in revenue in Kurdistan Region Government's fund after the financial crisis due to the decline in oil prices, it is clear that the main source of finance in this country is natural resources. Recently, Kurdistan Region Government like any other countries which are depending on natural resources for their funds, faced financial crisis due to the decline in oil prices and the reason is regressing of economic growth of both China and India. However, the companies are not willing to pay tax to the government because they do not trust them even if the government forced them to pay, the companies would prefer to conduct some services for the society instead of giving their tax to the government. However, this is a significant matter for the whole country because not paying tax to the government from any company will influence the economic, society, and even sometimes the politic as well in the country. Thus, rules and principles of external auditing in Kurdistan need reform and this can be conduct through Parliament. Hence, reviewing or checking the work of some departments in a company might be very easy because every work will be ended by the companies' staff and only reviewing it will be left for the external auditor while internal auditor will conduct this duty. Therefore, the external auditor's duty should be different agenda for instance, persuading accountants not to work illegally for the benefit of the companies that they are working on it. Likewise, providing necessary, logical information and advice the accountants

can drive the companies to perform their duty more efficiently in terms of taxation payment. Finally, the external auditor can play a significant role in developing and improving the countries' economic and consequently will affect the society as well, because not paying tax will affect the governments' funds to perform their duty in providing services to the people. Unfortunately, a lot of companies have not paid tax in Kurdistan due to lack of morality from the accountants and this might be because of the absence of law in this country. Obviously, if the law is playing its role the accountants cannot manipulate the financial statements, because if a particular accountant in a particular company is not doing what the companies owners says he/she will lose his/her job and the company will hire a new accountant. The financial crisis which has been occurred because of the decline of oil price in the world and the reason is the only source of finance in this country is natural resources in particular oil. Some of the companies might indicate themselves as a company for providing sand by putting a few vehicles in their company but in reality they might trade drugs or purchase weapons in the black market. Thus, external auditor should be more intelligent in collect sufficient appropriate audit evidence (Para A15) (Porter et al, 2008). Hence, some companies might be started with working in providing pipe but they may be started from current financial year. Therefore, inspecting the previous financial statements will be necessary to investigate the real profit of the company in their previous financial years. For instance, they might be worked in providing or importing white oil in three years ago (Para A16) (Porter et al, 2008). The main suggestion for the external auditor in Kurdistan could be that, they might advise companies and even the governmental offices not to depend on one source of finance to implement their economic duty because this will be very risky for them. In a circumstance of facing problem with the single source of finance, they will absolutely face bankruptcy risk in a very short time. Unfortunately, this situation has occurred in Kurdistan, the government is relying only on selling natural gas and oil as a financial fund and it sells only through Turkish government, if our government faces any political problem with Turkey government, this will be definitely affecting Kurdistan's economic situation negatively. Hence, the role of external auditor can be observed here by persuading the Kurdistan government to not depending on one way to sell the natural resources to achieve funds through his/her report. Depending on one source of finance is really risky and using one way to sell your natural resources will be twice risky.

7. Limitations

Unfortunately, there is no research in Kurdistan about audit evidence and audit procedure. Thus, we utilized books mainly instead of using articles as a referencing to support our discussion. Hence, due to the lack of security in Kurdistan the companies are not responding our questions so I just interviewed the external auditors in Kurdistan.

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