Materiality And Risk
Essential Pillars Of The Auditor's Work

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Abstract

This paper reports interview evidence on audit materiality and the answers to the variables regarding how the materiality of gray area (± 5% of defined materiality) determines the auditors' opinion. Focus-Groups Questionnaires is a Method of Collecting Qualitative Data, in our case, 215 Certified Public Accountants (CPA) from Authorized Accountant Experts Institute (IEKA), Albania. Opinion of the auditors about the financial statements, in cases of gray materiality´s area depends on the experience or the substantive audit procedures.

We have designed questionnaires regarding audit judgment based on the experience, gender, risk assessment, age. We have scrutinized albanian CPA giving a priority calculations and tests versus experience.

The Albanian auditor characteristic in professional judgment, is dependeble on substantive procedures, but auditors use their experience on enterprises operating in the same feld. The young experts use professional judgment more than personal judgment.

Keywords: Materiality; risk; professional judgment; substantive procedures

Introduction

The auditor is expected to design and conduct an audit that provides reasonable assurance that material misstatements will be detected. Materiality is a concept that relates to the significance or importance of an item (Lesli.D.A). Auditors and management sometimes have legitimate differences of opinion about the significance or importance of a misstatement. A misstatement is an error, either intentional or unintentional, that exists in a transaction or financial statement account balance. The auditor and management may disagree about whether a misstatement is material. A amount that may be sigificant to one person, may not be significant to another.

Despite these measurement difficulties, the concept of materiality is pervasive and guides the nature and extent of the audit opinion formulation process. Therefore, it is essential to understand materiality in the context of designing and conducting a qualitative audit. There are various definitions of materiality; we highlight several below that capture the essential elements of this concept.

In Concepts Statement No. 2, the Financial Accounting Standards Board (FASB) defines materiality as "the magnitude of an omission or misstatement of accounting information that, in light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or misstatement." ISA 320, Materiality in Planning and Performing an Audit, makes the point that auditors' judgments about materiality should be made based on a consideration of the information needs of users as an overall group.

Metodology

Materiality is considered as a key concept in the theory and practice of accounting and auditing. It is a significant factor in the planning of the audit procedures, performing the planned audit procedures, evaluating the results of the audit procedures and issuing an audit report.Cases of gray materiality´s area depend on the experience of auditors in determining the opinion on the financial statements. By the way of formulating hypothesis hints that the dependent factor is the way how the materiality of gray area (consequence) is determined and the cause must be the experience of auditor in the exercise of the profession.

As it is presented above, the concept of materiality of the grey area represents the effect, while the experience of the auditor in exercising of his profession, gender and age, as well as participation in consecutive audits are causes. This behavior can be translated as; experience, gender, age and participation in audits determine technique of materiality in the gray area.

The concept of materiality of gray area is measured by dummy variable with two attributes, where 1 is marked with experience and 0 is marked with substantive tests and tested population growth. Both these attributes are ways to measure the materiality of the gray zone. Its symbol is (matr_gri).

Experience of the auditor is measured by the number of years he has been practicing out his profession with the symbol *(pervj)*, while the age refers to years of auditor´s life with the symbol (*mosh)*. Gender is measured by a dummy variable, where 0 is female and 1is male with the symbol (*gjin)*, while participation in consecutive audits is measured with an ordinal dummy

variable, where 1 is the few option, 2 stands for some and 3 is for many, with the symbol (pj_aud).

It is asked to control the hypothesis that connects these variables in such a functional form:

$$matr\_gri = f\,(pervj, gjin, mosh, pj\_aud).$$

From earlier cases, the hypothesis is: Cases gray area materiality depends on the experience of auditors in determining the opinion on the financial statements. The shape of the equation for the model could be this:

$$P(matr\_gri_{0;1}) = \frac{1}{1+e^{-(\beta_0+\beta_1 pervj+\beta_2 gjin)}},$$

Results and Discussion

Cases of materiality of gray area depend on the experience of auditors in determining the opinion on the financial statements. To check this hypothesis, naturally raises the need of evaluating the relation of experience with cases auditors' materiality gray area through regression.

The following table provides the main results of the models estimated by the EViews8 software.

Table 1.Descriptive statistics categorized for the explanatory variables for the second model of materiality of the gray area, worked with Eviews8.

*matr_gri * pervj* Crosstabulation

Count

		Pervj										Total
		2	3	4	5	6	7	8	9	10	14	15	
matr_gri	*Substantive tests*	20	25	4	8	2	7	2	1	2	1	24	96
	Experience	0	0	2	0	0	1	2	5	1	1	24	36
	Total	20	25	6	8	2	8	4	6	3	2	48	132

Table 2. The categorical descriptive statistics for explanatory variables

Categorical Descriptive Statistics for Explanatory Variables

Variable	Mean Dep=0	Mean Dep=1	Mean All
C	1.000000	1.000000	1.000000
Exp	6.781250	12.77778	8.416667
Age	47.64583	54.05556	49.39394
Gender	0.447917	0.555556	0.477273

Variable	Standard Deviation Dep=0	Standard Deviation Dep=1	Standard Deviation All
C	0.000000	0.000000	0.000000
Exp	5.205671	3.514144	5.489812

Age	8.467870	6.645920	8.485963
Gender	0.499890	0.503953	0.501386
Observations	96	36	132

The following table reports the results of this test. Since the likelihood probability ration is almost p = 0.05, then with statistical certainty of 94% we can say that the age variable is not excessive for the second model. So, the age factor should not leave the regression. The presence of age in the model is also justified by statistical procedure.

Table 3. Test for excessive variables in the second model of materiality of the gray area, worked with Eviews8.

Redundant Variables Test
Equation: EQ02
Specification: *matr_gri c pervj mosh gjin*
Redundant Variables: *mosh*

	Value	Df	Probability
Likelihood ratio	3.595915	1	0.0579

LR test summary:

	Value	Df
Restricted LogL	-60.41745	129
Unrestricted LogL	-58.61949	128

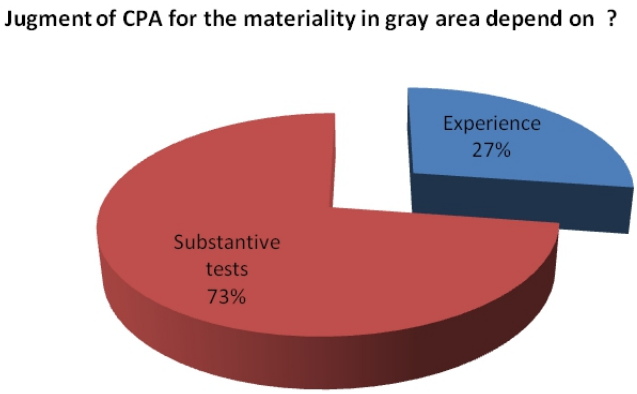
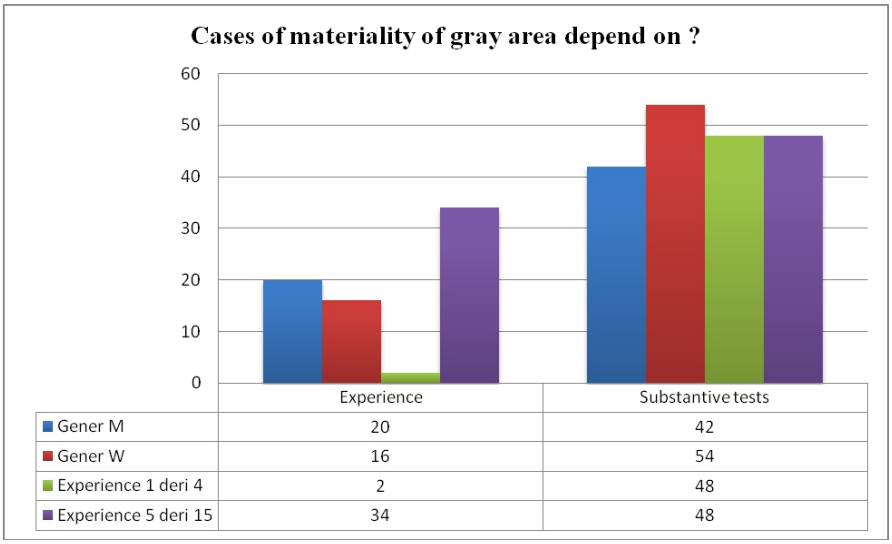


Figure 1. Trial of CPA in the gray area.



	Experience	Substantive tests
Gener M	20	42
Gener W	16	54
Experience 1 deri 4	2	48
Experience 5 deri 15	34	48

Figure 2. Distribution of calculation of materiality in the gray area by sex and experience.

By the same logic, it was controlled for missing or hidden variables for the second model. The following is illustrated the relevant test for size factor. Since the probability of the likelihood ratio statistic is greater than p = 0.05, then it is judged with the security level over 95% because size factor is not hidden for the model.

Conclusions

Our application has identified the existence of a strong correlation between the professional judgment and the substantive tests. Risks and experience are the methods that Albanian CPAs choose to determine the materiality.

CPA women are a little more careful than CPA men for choosing the substantive tests vs. experience. Young CPA choose substantive tests vs. Experience too.

The result of the study can have significant implication for IEKA and the Quality Audit Control which takes place once every five years for the experts on the field. For the young experts, it takes place only once every two years. The young experts use professional judgment more than personal judgment.

Also one thing that is noticed CPA women are a little more careful than CPA men after doing a rotation as experience and tests, this leads to reflect IEKA in quality control to be given a place with great control the CPA men. Obvious that the experts with the young and those who work in society are likely to use the tests assessed at Risk and materiality than experience.

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