



**AUDIT ASSURANCE AND MITIGATION OF FINANCIAL STATEMENTS
AMBIGUITIES: AN EXPLORATORY RESEARCH**

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Abstract

Financial statements of an enterprise are reports that provide information about the performance of a business useful for decision making by stakeholders. Unfortunately, the statements are often plagued with vagueness due to ambiguities. The study examined the causes of these ambiguities and explored ways they (ambiguities) could be mitigated. Relevant literature on the subject matter available from published articles available on the internet and in the library was reviewed. From the review, it was found that factors such as lack of clarity in disclosures, inconsistent application of accounting policy, use of jargon or technical terms, estimates in financial statements that require management judgment, subjectivity in valuation of items and inclusion of related party transactions to be the causes of ambiguities in financial statements. The study concluded though these ambiguities pose difficulties to users of financial statements, they can be reduced to the barest minimum. The study therefore recommended transparency in disclosure, avoidance of technical languages/terms and consistent application of accounting policy as measures that would mitigate the ambiguities capable of promoting trust and confidence of stakeholders in financial reports of enterprises.

Keywords: Financial statements, Ambiguities, Mitigated, Auditors, Accounting, Information
JEL Classification Codes: M400, M410, M20, M480

INTRODUCTION

Financial statements are structured reports that summarize the financial performance and state of affairs of an enterprise or an organization over a specific period. The statements provide essential information used by a variety of stakeholders including management, investors, creditors, analysts, bankers and regulatory authorities for decision making. The statements broadly classified into four namely; Income Statement (IS), Statement of Financial Position (SFP), Cash Flow Statement (CFS) and Statement of Change of Equity (SCE) are meant to provide various information about an organization for different purposes which include facilitation of financial position assessment, accountability and transparency enhancement, support compliance with regulatory authorities and to provide a basis for performance evaluation of an entity in terms of the financial health and growth opportunities. The statements also assist organizations in forecasting, planning and informing stakeholders of changes in the financial condition and performance of an entity (Hirto & Cymer, 2019). The statements are vital tools for assessing organization's overall health, performance and potentials for future growth benefiting a diverse array of stakeholders (Gilter & Nuber, 2021). Stakeholders are keenly interested in these statements as they would be able to assess the profitability and efficiency of a business overtime. Using the information obtained in the

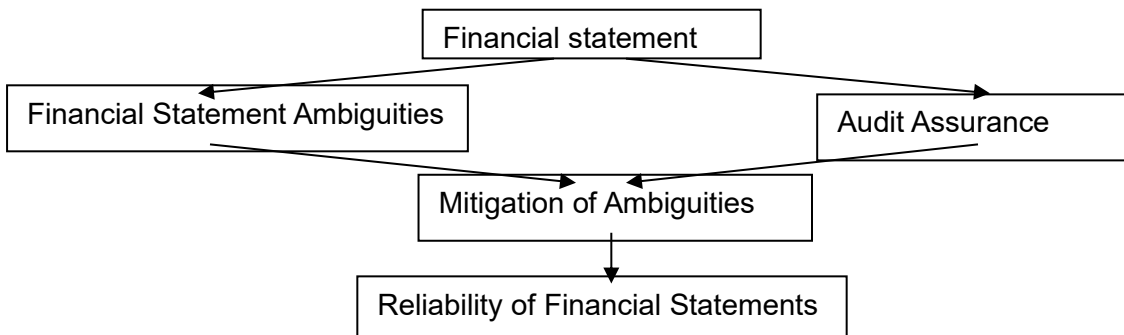
statements, stakeholders particularly management, investors and creditors would be able to make informed decision regarding resource allocation, operational strategies and investments (Arthur & Richter 2020, Kin & Dulman, 2022)

Although financial statements are veritable tools that provide information about business performance, they are often plagued with ambiguities that make them difficult for users to understand the true financial position and performance of organizations for valuable decisions (Bark & Firtz, 2024). Some of causes of these vagueness in the preparation and interpretation of financial statements of entities include complex accounting standards, inclusion of estimates and assumptions in the statements, inconsistent application of accounting policies, lack of clarity in disclosures, use of financial jargons or complex technical terms, different approaches to revenue recognition or timing of revenue recognition, transactions with related parties and subjectivity in valuation of items (Goll & Erpel, 2019; Nick & Moir, 2021, Neir & Sighger, 2022, Kennedy & Oduwumi, 2024, Omeganor & Manulor, 2024). Presence of ambiguities in financial reports has led to misinterpretation of financial statement by user of the reports and inability to correctly/accurately assess the performance of enterprises (Neir & Sighger 2024). Inability to ascertain true performance from reports of organizations has triggered stakeholders' distrust and loss of confidence in the accuracy of financial reports especially among investors (actual and potential) who are not able to make informed decisions due to ambiguous and unclear financial statements of enterprises. (Kennedy & Oduwumi, 2024, Omeganor & Manulor, 2024).The objective of this study therefore is to explore various ways assurance service of auditors could mitigate ambiguities in financial statements to promote transparency and reliability of financial report of organizations.

LITERATURE REVIEW

Conceptual Review

The conceptual framework of the study is as follows:



Financial Statements (FS)

This refers to reports that summarize the performance and financial health of an entity over a specific period of time (Thalmer & Plarker, 2019). The information contained in the reports when properly analysed and business stakeholders in making valuable decisions. Thus, Coryln and Ken (2019) viewed FS as reports that provide information about financial condition and performance of an organization to stakeholders. For instance, while IS reports organization's revenues and expenses of operation over a period resulting in net income or loss, CFS, SCE and SFP provide information about entity's cash inflows and outflows, changes in equity accounts including retained earnings and other income throughout the reporting period, liabilities and equity at specific point in time reflecting the financial position of the entity on a specific day (Corner &

Virly, 2019; Lynard & Marker, 2020; Williams & Hoss, 2021). Generally, the objective of FS is to provide information about financial performance helping stakeholders to assess profitability and efficiency of a business over time mainly for decision making (Jake & Schmirtz, 2020).

Financial statement Ambiguities (FSA).

The concept refers to uncertainties or unclear aspects in the presentation of financial statements that makes it difficult for users of the information contained therein to make valuable decisions (Boller & Arsh, 2019; Morgan & Duren, 2021). Major causes of FSA include complex accounting standards, estimates and assumptions made in financial statements, inconsistent application of accounting policies, lack of clarity in disclosures, Jargon and use of technical language, related party transactions included in FS and subjectivity in valuation of items (Ersen & Blair, 2019; Pretser & Aaron, 2019; Hillard & Ryne, 2021; Portter & Borgne, 2022; Fredson & Mooren, 2022; Syver & Chen, 2023; Danne & Irman, 2023; Chyker & Tirter, 2024, Carly & Jane, 2024). Ambiguities usually arise when users are not sure about the accuracy of information conveyed in FS making it difficult and challenging for users to compare financial results of an enterprise across periods. Unintended decisions of business stakeholders will always be the case when key information in FS are ambiguous, vague and unclear (Orkmmmer & Salmon, 2020).

Audit Assurance (AS)

This refers to the level of confidence that an auditor provides regarding the truth and fairness of entity's financial statements (Taylor & Leon, 2021). The assurance is a guaranty of the credibility and reliability of FS which entails a process where auditors examine financial records and express opinion on whether the records are free from material misstatement. The primary objective of audit assurance is to enhance the reliability and credibility of financial statement of clients (Murphy & Urcan, 2020). Reliability and credibility of FS are enhanced when causes of material misstatement of figures, non-compliance with accounting standards and ambiguities in statements/financial reports are detected and addressed (Dorwan & Turban, 2021). Other objectives of AS include evaluation of the effectiveness of internal control system, risk management support, evaluation of organization's compliance with regulations to ensure adherence, support management and board in redefining business strategy when necessary in order to promote trust of organization's stakeholders and helping to mitigate ambiguities in clients FS (Boxter & Bour, 2022; Dackson & Westlin, 2023).

Mitigation of Ambiguities

This refers to what to do in order to make FS clear, understandable and transparent to users. The concept has to do with reduction in the multiple interpretation of items in FS due misunderstanding of the manner in which the statements are presented (Reen & Dasch, 2020)). Mitigation of FS ambiguities generally refers to proactive measures that can be taken so that enterprises can avoid options that are considered to be ambiguous in FS (Gysen & Yemfen, 2019).

Theoretical Review

Information Asymmetry Theory

The theory is an idea that one party in a transaction has more information than the other which create imbalance of information. The theory was propounded by George Akerlof, Michael Spence and Joseph Stiglitz in 1970 (Gileon & Rajavan 2020). Two key assumptions of the theory include existence of different levels of information where over party in a transaction (the seller) has more

or better information than the other party(buyer) and rational decision making where both parties are assumed to be rational agents trying to maximize their utility. There is often an imbalance of information between parties in a transaction especially between management-seller of company's products always wanting to maximize enterprise's utility (profit maximization) and investors (the buyers) seeking information and transparency of management reports whether their wealth can be maximized (Clisson& Helti, 2021). The imbalance of information usually skewed in favor of management paved for the emergence of auditing service aimed at reducing/mitigating the information asymmetry so that stakeholders can make informed decisions.

Signaling Theory

The theory was developed by Michael Spence in 1973 (MacRuth & Christen, 2021). It is a fundamental concept that explains how people behave when they have access to different information. Key assumptions of the theory include existence of information asymmetry where the party (the informed) possesses more or better information than the other party (the informed) and existence of incentives for signaling where the informed party has an incentive to send a signal to convey their type and quality to the uninformed party. The theory suggests that firms use financial reporting and auditing as signal to communicate their quality and performance to the market. Unfortunately however, the reports can sometime be creatively prepared to signal good performance to entice the uninformed (MacRuth & Christen, 2021). An independent audit can reduce uncertainties surrounding reports of enterprises which can influence investors' perception and behaviours (Terber & Walker, 2023)

Role Theory

The theory was propounded by George Herbert Mead in 1920s and 1930s (Firtver, 2021).The Theory provides a framework for understanding how social expectations shape individual behavior and social interactions illustrating the interplay between structure and agency in social life. The key assumption of the theory is social identity based ones perception. Roles contribute to an individual's social and economic identity. How people perceive themselves and how others perceive them can be influenced by the roles they occupy. In auditing the theory focuses on the professional roles and responsibilities in assuring the quality of financial reporting especially how auditors navigate ambiguities in FS to provide reliable reports to influence and change the perceptions of stakeholders.

Agency Theory

It is an economics theory that studies the relationship between principal and agent. The theory was developed by Jensen and Meckling in 1976 (Orgeven & Fordmer, 2021). The theory has two key assumptions- existence of a principal and agent relationship and goals and interests' divergence principal – agency assumption is a postulation of the idea that there is a relationship between parties where one party (the principal) delegates decision-making authority to another party (the agent). The goals and interest divergence is an assumption that the goals and interests of the principal and the agent may not align. The divergence of interest can rise due to differing goals such as management seeking to present financial performance favorably while shareholders seek accurate, true and fair reporting. (Litnerts & Portken, 2021). Audit and assurance services of auditors seek to ensure true, fair and transparent reporting thereby narrowing the divergence of interests of two parties (Orgeven & Fordmer, 2021; Litnertz & Porten, 2021).

Decision Making Theory

The theory was developed by various scholars across multiple disciplines. Some key authors of the theory includes Herbert Simon's bounded rationality theory in 1957, James March and Herbert Simon's incremental decision theory in 1958, and Daniel Kahneman and Amos Tversky's prospect theory in 1979 (Morkeen & Lee, 2022). Key assumptions of the theory include rationality where decision makers make choices based on their goals and preferences, uncertainties, amount of information available, time pressure where decision makers often have to make choice within tight timeframes and value and preferences where in most cases decision maker's choice(s) is/ are driven by personal value, preferences and biases. The relevance of the theory to the study stems from its assumptions which are emphasis on the complexities and limitations of human decision making process. This study explores how proactive audit assurance can influence decision making processes of stakeholders given ambiguities in financial statements of enterprises.

Theoretical Framework

The study is anchored on decision making theory drawing from its emphasis on complexities and limitations human decision making especially under ambiguities of FSs of enterprises. Daily, individuals face decision making uncertainties. Individuals have different tolerance for risk that they are comfortable accepting and the amount of uncertainty that they are happy with to make decision. The role of audit assurance is mitigating ambiguities in FSs and uncertainties of stakeholders' decisions. The mitigation is relevant for valid decisions of business stakeholders especially investors.

Empirical Review

Studies have been conducted on financial statement ambiguities and understandability of reports of organizations. For instance in the UK Goll and Erpel (2022) did a study on financial statement ambiguities and reliability of financial reports. The aim was to ascertain the effects of ambiguities, on confidence in financial reports. Data for the study were obtained from the responses of 1255 respondents made up of financial analysts and managers of corporate organizations. Results of regression analysis indicated that ambiguities have negative effect on reliability of financial reports.

Nick and Moir (2022) investigated the effect of inconsistency of application of accounting policies on treatment of items in financial statements of enterprises. Data for the study were obtained from responses of business managers and financial analysts in the USA. Finding from description analysis of the data using mean scores, standard deviation and Analysis of Various (ANOVA) revealed that inconstancy of accounting policies have negative effects on credibility of financial reports as it create confusion and impairs comparability of reports over periods.

Neir and Sighger (2023) studied the challenges encountered by users of financial reports. Data for the study were sourced using questionnaire instrument. The questionnaires were administered on 1500 purposively selected respondents make up of managers of enterprises and investors. Results of descriptive analysis indicated that use of technical accounting language ranks highest among the numerous challenges of clarity of disclosures in financial statements of enterprises.

Ermoratzet al (2023) investigated the relationship between understandability of financial statement, complex accounting standards and estimates and assumptions in financial statements of

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enterprises. Data for the study were obtained using questionnaire administered on 675 respondents made up of corporate managers and investors in corporate organizations. Results of Partial Least Square Structural Equation Modelling (PLS-SEM) revealed existence of relationship between ability of users to read financial statements of enterprises (understandability) complexity of accounting standards, and reasonableness of estimates and assumptions of management in preparation of financial statements.

Kenedy and Oduwumi (2024) examined issues of performance evaluation and transparency of businesses in Nigeria. Data for the study were obtained from 1485 purposively selected investors in corporate organizations using open-ended questionnaires. Result of descriptive analysis of the data indicated that timing of revenue recognition and subjective valuation of intangible assets ranked top in creating ambiguities in financial statements of enterprises.

Omegakor and Manulor (2024) conducted a study on hindrances to assessing performance of businesses in Nigeria. From the descriptive analysis of the data obtained from 1240 financial analysts using questionnaires, it was found that inclusion of figure for non-financial performance indicators such as product quality and customer satisfaction are the major issues that create ambiguity in the interpretation of financial statements.

METHODOLOGY

It is an exploratory research on financial statement ambiguities and auditors' role in mitigating /ameliorating/reducing ambiguities in financial statements of organizations. In the process of sourcing data for the study relevant literature on the subject matter available on the internet as well as published articles from the library were also contacted.

DISCUSSION

Financial statements are structure reports that present information about business performance used by stakeholders for various decisions. Unfortunately however from literature reviewed it was found that accurate performance evaluation of businesses by stakeholders is always hindered due to ambiguities such as lack of clarity in disclosures, jargon and use of technical language, difference in timing of revenue recognition, related party transacting , subjectivity in valuation of items estimates and assumptions and inconstancy application of accounting policies in financial statements of enterprises (Goll & Erpel, 2019, Nick & Moir, 2021; Ermoraz et al, 2022; Neir & Sighger, 2023; Kennedy & Oduwumi, 2024; Omegakor & Manulor, 2024). The implications of these ambiguities in financial statements by users of FSs are distrust and loss of confidence in financial reports and inability to make informed decisions by business stakeholders (Neir & Sighger, 2023; Kennedy & Oduwumi, 2024 Omegakor & Manulor, 2024).

CONCLUSION AND RECOMMENDATIONS

This study explored the causes of ambiguities in FSs of enterprises and the ambiguities could be mitigated via audit assurance services of auditors. Being an exploratory study, literature on subject were reviewed. From the literature, it was found that presence of ambiguities in financial statement usually pose a lot of challenges for stakeholders particularly investors as they struggle to make decisions from ambiguous reports. However, the ambiguities can be addressed through audit-processes and advisory services in the following ways;

- i. Risk assessment: a comprehensive risk assessment by auditors to identify areas with higher susceptibility to misstatement or ambiguity in financial reporting, such as revenue recognition, estimate, and complex transactions can reduce ambiguities in FSs
- ii. Assessment of the efficiency and effectiveness of the internal control system of client: Evaluation of the adequacy of the client's internal controls can reduce the risk of ambiguity arising from misstatements or incomplete disclosures.
- iii. Advice on use of language in preparation and communication of financial reports: Advice of auditors for clients to avoid use of technical accounting terms in FSs can reduce difficulties of users in understanding of financial reports. The advice usually promotes transparency of management and confidence in statements prepared.
- iv. Evaluation of estimates in FSs: Auditor's evaluation of the rationale and methodology behind estimate in FSs of clients can help to ensure they are reasonable and well-supported either by application legislation or accounting concepts and convention.
- v. Analytical procedures: analytical procedures of auditors usually done to compare financial ratios or trends over time and against industry benchmarks can assist in detecting inconsistencies or unusual variances in client's disclosures in FSs. The detection, explanation and revision of figures that may be required by auditor in FSs can assist in reducing ambiguities in the statements.
- vi. Discussion of findings: Discussion of findings of auditors with clients of ambiguities in FSs prepares before final statements and audit report are issued can help in reducing ambiguities in the statements. The essence of the discussion with management is to find solutions to identified ambiguities.

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