

The Relationship Between the Audit Report and the Commercial Decisions: Evidence from Spain

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Abstract: This paper presents an empirical study of the degree to which audit reports provide information relevant to the evaluation of the companies commercial risk. To this end, an experimental study has been conducted based on a survey of commercial risk analysts employed in Spanish companies. The results indicate that the type of audit report (unqualified or qualified) does have an influence on commercial decisions taken by risk analysts. In particular, there are differences between an unqualified and qualified audit report if we analyse the following decisions: when commercial risk analysts decide to begin commercial relationships with another company, when they evaluate the risk of the commercial operation, when they demand additional guarantees beyond the normal and when they must decide the amount of commercial credit to grant to the possible client. On the other hand, the results have shown that the effect of the nature of the qualification differs depending on the decision to be taken by the commercial risk analysts.

Key words: relevance, audit report, commercial risk analysis, auditing in Spain

INTRODUCTION

In 1988, Spanish Act 24/1988 regarding the securities Market was passed leading to the greater transparency, liquidity and efficiency of the Stock Market. Although the Spanish Stock Market is efficiently organised, it still has a relatively low number of listed companies. Furthermore, it should be added that the total of quoted companies represents a very small percentage of the total of all limited companies that exist in Spain; this latter total was 129,349 in December of 2001 (INE, 2002). In this sense, Fernández, 1991 states: really, only those Spanish companies of appreciable size that have their shares quoted on the stock market can be considered to have access to significant equity finance through the periodical issue of shares and bonds. Most of the companies have to resort to credit and loans to obtain financial resources; that is, they have to request financing from credit entities or other firms. In Spain, there is a predominance of small and medium-sized businesses that are not normally listed on the stock market. This forces them, in part, to resort to other sources of finance, by which we are referring basically to loans from credit entities or credit from other firms.

Focusing on the credit between firms, a company, before making a decision as regards the possible concession of a credit, carries out a detailed study of the client requesting the credit. In this way, they aim to find

out the clients capacity to return the credit, together with his business liquidity. Although companies could request this information from the business itself or from other sources, credit officers or commercial risk analysts must have information regarding the operational activities and financial condition of a firm to make reasonable decisions about whether to begin a commercial relationship and give credit. Financial statements of a business are designed to give a significant portion of this type of information. They are prepared by company management and may be objective presentations of financial conditions and operating activities of a business. Credit officers should require that financial statements attach a report by an independent auditor attesting to their fairness and preparation in accordance with generally accepted accounting principles, that is, an audit report.

The companies that normally use the services of other companies are small or medium-sized businesses not listed on the stock market and, consequently, they are not obliged to publish periodic information. From a theoretical point of view, financial statements and audit reports are, therefore, valuable, trustworthy sources of information for the commercial risk analysts working for companies.

From our perspective as accounting researchers, we would like to know to what extent the auditing is relevant on the Spanish firms commercial policy; focusing particularly on the analysis of the commercial risk since in Spain there is not evidence regarding this subject. It is

important to notice that the study does not try to establish a determination model of commercial risk, analysing the order of the items considered nor it tries to seek, after, an internal coherence or behaviour pattern on the responses. This would be an aim much more ambitious than we try to reach on this paper, which is not analysed within the research line about the information content of the audit report; this latter being the objective of this study. Concretely, we aim to analyse how some commercial decisions are affected by qualified audit reports, according to a level of risk given. The instructions sheet, attached to the questionnaire, stated that all the risk assessments proofs had already been done with a positive result for the firm analysed (the limited company was not at any registers of non-payers, that is, the client was not known to be in default, nor any negative commercial report had been obtained on it). This implies to drive the answers to the audit report, what is necessary for the study because it is the only way to isolate other effects. We must take into account that the study focuses on the analysis of the information content of the audit report.

In the study presented here, the research technique used to obtain the empirical data is a survey by means of questionnaires distributed to the risk analysts of companies. Through such a survey, we have tried to analyse whether the commercial decisions are affected differently by unqualified audit reports compared with those containing qualifications and also whether the various different types of qualification affect the decisions of the analysts in different ways. If this is found to be so, we can conclude that the analysts surveyed do consider the content of the audit report to be relevant when taking commercial decisions.

This article adopts the following structure. After this introduction, there is a brief summary of accounting literature on the relevance of audit reports in the contexts of the capital markets and credit entities. In the third section, we describe the methodology, hypotheses to be tested and the sample used in the empirical study. In the fourth section, the results obtained are presented and analysed and in the fifth part the main conclusions drawn are highlighted. Lastly, in the sixth section, the limitations of the study are stated.

REVIEW OF THE INTERNATIONAL LITERATURE ON THE RELEVANCE OF AUDIT REPORTS

Before undertaking this empirical research, an exhaustive review has been made of the international literature on this subject. Such review has revealed that

capital markets and credit entities are the most frequent areas where researchers empirically test the relevance or usefulness of the audit report for making-decisions by users (Strawser, 1991 and Ruiz Barbadillo, 1997).

Although the results obtained from this review do not offer evidence clearly supporting the relevance or usefulness of the audit report, it has served to establish the objectives and methodologies that we could use for a study of similar nature for the situation in Spain, as any study regarding the effect of audit report on commercial risk analysts decisions has been found in the literature.

Having reviewed previous research on the relevance of the audit report for credit entities and stock markets, the following conclusions should be noted. First, everything seems to indicate that research in the field of credit entities arises as a complement to efforts made to obtain evidence on the relevance of auditing in other fields such as stock markets. In respect of the methodology used in credit entities, it is found that they usually utilise laboratory experiments or questionnaires, whereas in stock market studies they generally make use of the well-known methodology event studies. The credit entities constitute a much more propitious context for the application of experimental methods of study than the stock markets. To do this research we have used the same methodology employed by the credit entities studies as we can see below.

Second, it has been found that, neither in this field nor in context of stock exchanges, previous studies share a clear common direction as regards the conclusions obtained. Some international studies revealed that the qualifications and the level of security offered by the auditors in their audit report did not affect the decisions of the risk analysts for the purposes of granting a loan^[4-7], whereas in other studies^[8-12] it was found that the different qualifications were relevant factors for the risk analysts when they were deciding on the offer of a loan. In the context of the capital market, the findings are contradictory as well. Works such as Baskin^[13], Alderman^[14], Davis^[15] and Mittelstaedt *et al.*^[16], did not report significant price responses for qualified audit reports. On the other hand, Ball *et al.*^[17], Chow and Rice^[18], Elliot^[19], Dopuch *et al.*^[20], Fields and Wilkins^[21], Fleak and Wilson^[22], Chen and Church^[23], Carlson *et al.*^[24], Seipel and Tunell^[25] and Soltani^[26] provided significant evidence of stock price reaction to qualified audit reports. The majority of studies of both contexts, that is, credit entities and capital markets, were undertaken in the Anglo-Saxon areas countries.

The establishment of obligatory auditing in Spain is relatively recent, following the promulgation of Law 19/1988, on 12th of July, enacted by the Royal Decree 1636/1990, on 20th of December. For this reason, little evidence exists regarding the effect of audit reports on users decisions. In this sense, we can refer to the works of Del Brío^[27], Cabal^[28], Castrillo *et al.*^[29] and Pucheta^[30], which have studied the relevance of audit reports on the Spanish capital market and Vico and Pucheta^[30] study, which has analysed the relevance of audit report in Spanish credit entities. Del Brío^[27], Cabal^[28] and Castrillo *et al.*^[29] analysed the information content of audit reports in Madrid Stock Exchange and Pucheta^[30] on the Spanish Continuous or Interconnected Market (it is based on a computerized network, which connects the four Spanish Stock Exchanges, i.e. Madrid, Barcelona, Valencia and Bilbao). The results were mixed. While Cabal^[28] and Castrillo *et al.*^[29] studies supported that audit reports had information content, Del Brío^[27] and Pucheta^[30] did not find this evidence. As regards the usefulness of the audit report in Spanish credit entities, Vico and Pucheta^[31] showed that it provided relevant information for risk analysts when taking decisions regarding the concession of loans.

The findings of these studies offer ambiguous support for the view that audit report contains information or is useful for investors and risk analysts working for credit entities. This provides an unclear understanding of the significance of the auditors role in the contexts of the capital market and credit entities. The lack of usefulness of the audit report can be criticised nowadays when users demand higher quality information.

METHODOLOGY, HYPOTHESES AND STUDY SAMPLE

Methodology utilized in the study and The hypotheses to be tested:

Design of the experimental study: In the 1970s, Carmichael^[32], indicated the need to investigate the influence of the audit report on the decision-making process of the users, suggesting that the best methodology to use is the experimental simulation, because this allows the relevant variables to be controlled, as well as being the most logical choice to obtain the data required for performing the study. In an experimental simulation, the researcher creates a situation in which the actions of the participants can be studied and tries to make that situation a faithful representation of the natural scenario.

In present study, the experimental simulation applied to the commercial risk analysts subjected them to a

decision process in a simulated context presented to them by means of a dossier given to them by post.

The simulated situation contained in this dossier may be expressed in the following terms: the limited company X wishes to begin commercial relationships with another firm, i.e. firm Y. In response and in order to evaluate the risk that this would imply for the firm Y, it requests from the company X its latest annual accounts with the corresponding audit report. The company X enjoys a healthy financial situation, according to the annual accounts, so the decision maker will not be distracted from the response task by atypical values: in particular, it presents a current ratio of 1.02, a quick ratio of 0.74, a debt to asset ratio of 0.72, a Return on Assets Ratio (ROA) of 12.20% and a return on equity ratio (ROE) of 23%. On the other hand, it can offer all the necessary corporate and personal guarantees. The only element that could influence the decision to begin or refuse the commercial relationship is the content of the audit report.

With the aim of enhancing the capacity of the experiment to reveal and clarify the relevance of the content of the audit report, this was disaggregated into five different versions, that is, in five experimental groups. Each one of the groups, which we designated as group 1, 2, 3, 4 and 5, received the annual accounts and two audit reports. The participants all received the unqualified audit report (FAV) and, respectively, (1) an audit report with a qualification for uncertainty in respect of the future viability of the company (going concern qualification) (IG); (2) an audit report with a qualification for non-compliance with accounting principles and standards that affects both the solvency and the profitability (INRS); (3) an audit report with a paragraph of emphasis that could also be interpreted as an important qualification (PE)¹, as this paragraph hidden a going concern qualification; (4) an audit report with a qualification for uncertainty regarding the outcome of a tax inspection (IF) and (5) an audit report with a qualification for non-compliance with accounting principles and standards that severely affected the profitability only (INR)². Audit reports with a qualification for changes in generally accepted accounting principles and standards were not included in the study because we understand that, in certain way, they are a subgroup within the qualifications for non-compliance with accounting principles and standards. Nevertheless, it can be interesting to compare the effect of a non-compliance to a change in GAAP with identical quantitative impact in the analysis. In Annex 1 to this work, we present the quantitative impact of the qualifications analysed in this study on the ratios previously referred to.

Chart 1: Types of report that accompanied the questionnaire in each experiment

	1	2	3	4	5
	Annual accounts	Annual accounts	Annual accounts	Annual accounts	Annual accounts
FAV	Unqualified report	Unqualified report	Unqualified report	Unqualified report	Unqualified report
IG	Uncertainty for going concern	-	-	-	-
INRS	-	Non-compliance affecting both the profitability and solvency	-	-	-
PE	-	-	Paragraph of emphasis including a qualification	-	-
IF	-	-	-	Uncertainty in respect of taxation	-
INR	-	-	-	-	Non-compliance affecting the profitability

Annex 1: Some financial ratios of the company

	Ratios, according to the audit report FAV, IG, PE, IF ¹	Adjusted ratios, according to the report INR ²	Adjusted ratios, according to the report INRS ²
Return on assets	0.122	0.039	0.042
Return on equity	0.230	-0.072	-0.085
Current ratio	1.020	1.020	0.890
Working capital	68.203	68.203	-392.797
Quick ratio	0.740	0.740	0.620
Debt to asset ratio	0.720	0.720	0.780

1) The unqualified audit report, the report with a qualification for going concern, the report with a paragraph of emphasis and the report with a qualification for uncertainty regarding the outcome of a tax inspection do not give rise to accounting adjustments. For this reason, the ratios are those obtained from the own annual accounts presented by the company, 2) The qualified audit reports INR and INRS give rise to adjustments that modify the ratios obtained from the own annual accounts presented by the company

By way of summary and to clarify the content of the material received by each experimental group, chart 1 is presented.

To each individual participant assigned to each of the five experimental groups, a dossier with all the information previously referred to and giving instructions on how the experiment was to be conducted, was sent by post. The result of the participants analysis of the risk for each scenario that was proposed in the corresponding dossier had to be recorded in a questionnaire, also included in the dossier and returned by post to the research group. To test the validity of the dossier, pilot surveys were carried out with two commercial risk analysts of two Spanish companies. These provided suggestions and comments that considerably improved the conduct of the experiment.

Design of the questionnaire: The questionnaire used comprises three sections (Annex 2). The objective of the first section is to obtain data relating to the subject participating in the experiment. Specifically, it requests (with the option of refusal) the name of the firm in which the commercial risk analyst works, the position of

responsibility held, the length of service of the analyst in that position, the academic training of the analyst, if the company is quoted or not, the company size (employees number and annual sales) and the company industry.

The second section contains questions put to the analyst to determine four specific items: whether the reading of the audit report represents a customary practice when evaluating a commercial risk; whether the analyst is familiar with the terminology and meaning of this type of report; the analysts readiness to seek additional data relating to the problems that may be indicated in the audit report and whether the analyst is obligated to read the audit reports because it is required by the internal control systems.

The third and last section contains the questions by which the experiment itself is conducted. We arrived at the following four scales (4 decisions) by means of the pilot surveys that we carried out with two commercial risk analysts and prior research regarding the impact of audit qualifications on lending decisions.

Since qualified audit reports provide additional information about future cash flows, or direct users attention to the impact of the qualification on future cash flows, the qualification should be informative to commercial risk analysts. They must determine the firms ability to service the credit. This requires an assessment of the companys current financial condition and future cash flows. In addition, the various types of audit qualification may, therefore, be expected to have differing impacts on credit granting decisions. Prior research^[26] has shown that various types of audit qualifications have differing impacts on investment decisions and share prices. Houghton^[6] based on the proposition that, when presented with audited financial information, bank staff are more inclined to approve a loan application which has data including an unqualified audit report, compared to data which include a significantly qualified audit opinion.

ANNEX 2
QUESTIONNAIRE

SECTION 1. DATA RELATING TO THE SUBJECTS

Questionnaire number	
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Company in which you work (with the option of refusal) Industry		
Industry		
Size	Annual sales(millions of pesetas)	Employees number
Is your company quoted?		
Position of responsibility		
The length of service in that position		
Academic training		

SECTION 2. GENERAL QUESTIONS REGARDING THE AUDIT REPORTS

Question 1	ALWAYS	SOMETIMES	NEVER
Does the reading of the audit report represent a customary practice when evaluating a commercial risk?			

Question 2	YES	No
Do the internal control systems of your company require reading the audit report of the client companies?		

Question 3	YES	No
Are you familiar with the terminology and meaning of the audit reports?		

Question 4	NONE	LOW	AVERAGE	HIGH	VERYHIGH
Which is your readiness to seek additional data relating to the problems that may be indicated in the audit report?					

SECTION 3. QUESTIONS RELATIVE TO THE EXPERIMENTAL STUDY

Question 5 Would you initiate commercial relationships with limited company X, if the real audit report were...?		UNQUALIFIED AUDIT REPORT	QUALIFIED AUDIT REPORT
	YES		
	NO		

Question 6 According to each scenario, would you rank from 0 to 6 (lowest to highest) the commercial risk?		UNQUALIFIED AUDIT REPORT	QUALIFIED AUDIT REPORT

Question 7 Would you demand additional guarantees if the real report were...?		UNQUALIFIED AUDIT REPORT	QUALIFIED AUDIT REPORT
	Yes (indicate which)		
	NO		

Question 8 According to the content of the audit report, would you modify the amount of commercial credit to grant to the possible client?		UNQUALIFIED AUDIT REPORT	QUALIFIED AUDIT REPORT
	YES		
	NO		

Following to this author, we also base on the proposition that, when presented unqualified audit report, commercial risk analysts are more inclined to begin a commercial relationship, to asses a lower level of risk, to require less additional guarantees and to grant a higher commercial credit, compared to a qualified audit report.

We analyse the relation between unqualified and qualified audit reports and each of these four decisions, that is, to begin a commercial relationship, level of risk, demand for guarantees and the amount of credit to grant. Then, the questions formulate were: a) if the commercial relationship with firm X would be begun if the real audit report for the annual accounts provided by company X were the unqualified audit report, or the other reports (containing one of the five kinds of qualification) presented in the particular dossier received, b) to grade on a scale of 0 to 6 the level of commercial risk of the two different scenarios presented (i.e. the scenario of the unqualified report and that of the second report with the qualification) c) whether additional guarantees, beyond

those normally required, would be demanded from the company as a condition for the commercial relationship and d) whether the content of the audit report (unqualified or qualified) would modify the amount of commercial credit to grant to the possible client.

Hypotheses to be tested: The content of the third section are the questions in which the eight hypotheses to be tested are given. The hypotheses were formulated in the following terms:

- H₀₁: The decision with regard to begin commercial relationship is independent of the type of audit report (unqualified or qualified).
- H₀₂: The decision with regard to begin commercial relationship is independent of the nature of the qualification.
- H₀₃: The level of risk associated with each of the scenarios is independent of the type of audit report (unqualified or qualified).

- H₀₄: The level of risk associated with each scenario is independent of the nature of the qualification.
- H₀₅: The demand for guarantees additional to those customarily required is independent of the type of audit report (unqualified or qualified).
- H₀₆: The demand for guarantees additional to those customarily required is independent of the nature of the qualification.
- H₀₇: The amount of commercial credit to grant to the possible client is independent of the type of audit report (unqualified or qualified).
- H₀₈: The amount of commercial credit to grant to the possible client is independent of the nature of the qualification.

The Chi-squared test of independence applied to the tables of contingency in which the responses to each of the questions are given has been utilised to test these hypotheses. This is a non-parametric test that, unlike the parametric tests, does not require the normal distribution of the variable observed and that also is especially useful in the case of small samples such as in our study. When the result of the application of the test leads to the acceptance of the null hypothesis, it can be concluded that the audit report is not relevant, i.e. that the report has had no effect on the beginning of commercial relationships, on the evaluation of the risk, on the demand for additional guarantees nor on the amount of commercial credit to grant. In contrast, in the cases where the null hypothesis is rejected, the conclusion would be the opposite, i.e. that the audit reports have influenced these decisions.

Study sample: As previously commented, the subjects who were to participate in the experiment had to be commercial risk analysts employed by Spanish companies. In total 500 dossiers were distributed and a total of 74 completed questionnaires were received, representing a response rate of 14.8%³. The demographic characteristics of the participants whose responses were analysed and some characteristics of the companies in which they work are summarised in Table 1.

All the subjects who responded to the questionnaire are commercial risk analysts. The respondents mean length of service in their current position is 6.8 years, with a range of between 1 and 22 years of experience. As we can see in table 1, 50% of the respondents had 6 years or less of experience. Of the total respondents, 74% hold degrees in economics and business studies, 9% hold diplomas in business studies and the remaining 17% hold other educational qualifications.

Table 1: Demographic characteristics of the participants and companies

	Years experience	Annual sales	Employees
Mean	6.78	256.234	2.253
Median	6.00	37.679,50	837
Minimum	1.00	277	69
Maximum	22.00	7.328.135	32000
SD	4,685.00	97.3075.73	4.513.925
Title			
Commercial risk analysts	74.00		
Degree			
Economics and business	55.00		
Diplomas in business	7.00		
Law	2.00		
Others	10.00		
Quoted companies			
Yes	15.00		
No	59.00		

The 20.3% are quoted companies, with the 79.9% remaining pointing out that they are not. Regarding the company size, on average, the companies had 2.253 employees, with a range of between 69 and 32.000 employees and their annual sales were 256.234 millions of pesetas, with a range of between 277 and 7.328.135 millions of pesetas of annual sales. 50% of the companies had less than 837 employees and 37.679,50 millions of pesetas of annual sales. The participants industries were: 10.8% automotive, 12.2% chemistry, 13.5% buildings, 16.2% food and the 28% remaining are from other industries.

Of the analysts surveyed, 31.83% declared that they always read the audit reports as a customary practice in their evaluation of credit risks⁴, with the 55.41% stating that they only read them sometimes and the 13.51% stating that they never read them. However, 100% of respondents asserted that they are fully familiar with the terminology and meaning of the audit report. As regards whether the company's internal control system requires reading the audit report 64.9% stated no and 35.1% answered yes. In respect of their degree of readiness to consult additional sources for information relating to the problems identified in an audit report, 46% claimed that this to be very high, 14% to be high, 27% to be average, 11 to be low and 3 to be none.

RESULTS

Evaluation of the relevance of the report in respect of beginning commercial relationships (hypotheses H₀₁ and H₀₂): An initial consideration of the results of the study consists of evaluating the relevance of the audit report by comparing whether there exist significant differences between the set of scenarios proposed, for the hypothesis H₀₁. In Table 2, we give the results obtained.

Table 2: Contingency table for beginning commercial relationships, according to the type of report and values taken by the χ^2 for the comparison between the unqualified audit report and each of the other types of report. Question asked: Would you begin commercial relationships with firm X if the real report were ... ?

	FAV	IG	INRS	PE	IF	INR	Total	χ^2_5	
YES	74	2	11	0	18	0	105	106.45 *	
NO	0	12	7	13	3	8	43		
TOTAL	74	14	18	13	21	8	148		
	FAV	IG	Total	χ^2_1		FAV	INRS	Total	χ^2_1
YES	14	2	16	21*	YES	18	11	29	8.69*
NO	0	12	12		NO	0	7	7	
TOTAL	14	14	28		TOTAL	18	18	36	
	FAV	PE	Total	χ^2_1		FAV	IF	Total	χ^2_1
YES	13	0	13	26*	YES	21	18	39	3.23 ns
NO	0	13	13		NO	0	3	3	
TOTAL	13	13	13		TOTAL	21	21	42	
	FAV	INR	Total	χ^2_1					
YES	8	0	8	16 *					
NO	0	8	8						
TOTAL	8	8	16						

*Significant difference at 1%, NS = Non-significant

Table 3: Values taken by the variable χ^2 for the comparison between pairs of reports with qualifications. Question asked: Would you begin commercial relationships with the firm X if the real report were ... ?

	IG	INRS	PE	IF	INR
IG	—	$\chi^2_1=7.16 *$	$\chi^2_1=2.00$ ns	$\chi^2_1=17.5 *$	$\chi^2_1=1.26$ ns
INRS	—	—	$\chi^2_1=12.31 *$	$\chi^2_1=3.08$ ns	$\chi^2_1=8.47 *$
PE	—	—	—	$\chi^2_1=23.68 *$	—
IF	—	—	—	—	$\chi^2_1=18.08 *$

* Significant difference at 1%, ns = Non-significant

The value observed for χ^2 with 5 degrees of freedom leads us to reject the null hypothesis H_{01} at the 1% level of significance for the set of scenarios described. Therefore, given these results, we can conclude that the decision to begin commercial relationships does depend on the type of audit report. However, it calls the attention that two participants decided to begin commercial relationships for the audit report with a going concern opinion, while that for the audit report with a paragraph of emphasis that hides a qualification for going concern and for the audit report for non-compliance that affects the profitability, this latter qualification less serious than the qualification for going concern, the analysts always rejected the beginning of commercial relationships. We returned to the questionnaire of these two respondents in order to look if they stated the company's name with the purpose of having a dialogue with them. It was not possible since they did not indicate it. However, we could observe in the questionnaires that both analysts would demand extra guarantees in order to ensure that the firm could serve the credit, concretely bank guarantees and credit insurance.

Next, we have tested the significance of the differences obtained in the responses of the analysts by comparing the unqualified audit report with each of the

other five types of report presented; that is, we have tested five pairs of observations. The results are also shown in Table 2.

The first point to be noted is that the difference in the opinion revealed is not significant only in the FAV/IF combination; in this case the null hypothesis of independence of beginning a commercial relationship respect of the content of the report, would not be rejected and, therefore, it should be interpreted that the qualification for taxation uncertainties does not affect the decision to begin a commercial relationships with the firm X. This result can go against the most habitual interpretation for taxation uncertainties. Generally, the qualification for uncertainty is associated by the reader with an outcome that will give rise, with a high probability, to an expense and a debt. Probably, the participants do not necessarily associate a qualification for uncertainty with an unfavourable outcome, although it is true that the practices in the auditing profession lead to qualify as qualifications the uncertainties in which the probability of occurrence of an unfavourable result is high.

In the rest of the cases, the null hypothesis is always rejected and consequently it can be stated that the rest of the reports do affect the decision. In the light of the quantitative impact of the qualifications expressed in Annex 1, whereas what we have commented is not strange a priori for pairs FAV/INRS and FAV/INR, since both of them present different ratios, it can be surprising for the combinations FAV/IG and FAV/PE. We must remember that these two pairs have in common that they are paragraphs that do not suppose adjustments to the accounts; however, IG and PE opinions reveal one of the

Table 4: Contingency table of the evaluation of the commercial risk and values taken by the variable χ^2 for the comparison between the unqualified report and each of the other types of report

Question asked: Would you rank from 0 to 6 (lowest to highest) the commercial risk, according to each scenario?

	FAV	IG	INRS	PE	IF	INR	Total	χ^2_5
0	19.00	0	0.00	0.00	0.00	0.00	19.0	228.28 *
1	19.00	0	0.00	0.00	0.00	0.00	19.00	
2	21.00	0	0.00	0.00	0.00	0.00	21.00	
3	15.00	0	7.00	0.00	6.00	0.00	28.00	
4	0.00	0	2.00	3.00	11.00	3.00	19.00	
5	0.00	0	7.00	5.00	4.00	3.00	19.00	
6	0.00	14	2.00	5.00	0.00	2.00	23.00	
Total	74.00	14	18.00	13.00	21.00	8.00	148.00	
Mean	1.43	6	4.22	5.15	3.90	4.88	3.07	

	FAV	IG	Total	χ^2_2	FAV	INRS	Total	χ^2_7
0	0	0	0	28 *	0	7	0	0
1	8	0	8		1	3	0	3
2	0	0	0		2	6	0	6
3	6	0	6		3	2	7	9
4	0	0	0		4	0	2	2
5	0	0	0		5	0	7	7
6	0	14	14		6	0	2	2
Total	14	14	28		TOTAL	18	18	36

	FAV	PE	Total	χ^2_5	FAV	IF	Total	χ^2_5
0	7	0	7	26 *	0	5	0	5
1	0	0	0		1	0	0	0
2	6	0	6		2	9	0	9
3	0	0	0		3	7	6	13
4	0	3	3		4	0	11	11
5	0	5	5		5	0	4	4
6	0	5	5		6	0	0	0
Total	13	13	26		Total	21	21	42

	FAV	INR	Total	χ^2_4
0	0	0	0	16 *
1	8	0	8	
2	0	0	0	
3	0	0	0	
4	0	3	3	
5	0	3	3	
6	0	2	2	
TOTAL	8	8	16	

* Significant difference at 1%

Table 5: Values taken by the variable χ^2 for the comparison between pairs of reports with qualifications. Question asked: Would you rank from 0 to 6 (lowest to highest) the commercial risk, according to each scenario?

	IG	INRS	PE	IF	INR
IG	—	$\chi^2_2=24.89^*$	$\chi^2_2=13.14^*$	$\chi^2_3=34.33^*$	$\chi^2_3=17.11^*$
INRS	—	—	$\chi^2_2=10.72^*$	$\chi^2_3=9.13^{**}$	$\chi^2_3=11.89^*$
PE	—	—	—	$\chi^2_3=14.44^*$	$\chi^2_3=3.42$ ns
IF	—	—	—	—	$\chi^2_3=16.68^*$

* Significant difference at 1%. ns=Non-significant difference

most serious problems that can happen in a company, that is, doubts on the future viability. This can explain why both combinations offer significant differences.

With the testing of the second hypothesis (H_{02}), the aim is to go beyond the proposition formulated in the first. We wish to ascertain not only whether the type of report is a determining factor in the beginning of the commercial relationship, but also whether there exists any type of qualification that affects the decision in a different way

from the rest. For this test, we pair together all the types of audit report with qualifications, except the combination PE/INR, since the analysts always refuse the beginning of commercial relationships in both cases, thus making the calculation of the test impossible. As can be observed in Table 3, in all cases except three, the Chi-squared values lead to the rejection of the null hypothesis. From this, we can state that different qualifications give rise to different decisions. The three exceptions mentioned are the going concern qualification compared with the paragraph of emphasis and with the non-compliance with accounting norms that affect the profitability, as the non-compliance with accounting norms that affect both the solvency and the profitability compared with taxation uncertainties.

The result obtained for the first exception indicated, that is, IG/PE, does not surprise, since both audit reports express, explicitly or implicitly, a going concern problem. However, from our point of view, that the combination

IG/INR does not offer significant differences can seem incoherent, although arguments can also be offered to defend its coherence. At first it would be possible to expect a significant difference, since as it is observed in Annex 1, the return on equity for case INR is negative and the return on assets considerably makes smaller, while going concern opinion does not suppose directly an adjustment to these returns. Even so, it is important to point out that the expected is that in none of the two cases commercial relationships begin, for which it would be coherent that the combination analysed did not offer significant differences.

Also it can seem incoherent that the combinations IG/IF and PE/IF present significant differences, since none of these opinions gives rise to accounting adjustments and, therefore, do not suppose any change of the ratios derived from the own accounts presented by the company. Nonetheless, the idea that the effect on the analysts decision is not the same in the presence of a going concern opinion than in the presence of a taxation uncertainty opinion, in spite of being this latter an uncertainty as well, can be also supported. The common sense makes suppose that the repercussion on the analysts decision will be bigger for going concern opinion than for a taxation uncertainty.

Evaluation of the relevance of the report in respect of the risk associated with each scenario described in the audit reports (hypotheses H_{03} and H_{04}): The hypothesis H_{03} affirms that the degree of risk estimated by the analyst is not found to be influenced by the content of the audit report. In this case, the respondents indicated a grading from 0 to 6 of the level of risk of the commercial operation, where 0 represents the absence of risk and 6 a maximum risk.

Table 4 presents the results obtained and the value taken by the Chi-squared statistic for the set of observations. As can be seen, the null hypothesis should be rejected at 1% level of significance and consequently it can be stated that the audit report does affect the degree of commercial risk estimated and, therefore, is relevant for this purpose. On average, the risk assessment was higher in the case of the qualified audit report (ranged from 3.90 to 6, according the nature of the qualification) than the unqualified audit report (1,43) (Table 4). These values also offer evidence that the qualified audit report did affect the commercial risk analysts decision making.

The same conclusion is reached if the more detailed analysis is done comparing the unqualified audit report with any of the five types of report presenting qualifications. All the combinations offered significant differences (Table 4) and therefore, we can conclude that

risk analysts perceive different degrees of commercial risk between the unqualified audit report and the qualified reports analysed.

In Table 2, we explain why significant differences would have to be expected for the following pairs:

FA/IG; FAV/INRS; FAV/PE and FAV/INR.

In relation to the pair FAV/IF the difference is subtler, as the problem is neither quantified nor has its outcome, necessarily, to be negative. Nevertheless, the analysts have assessed the uncertainty to such an extent that has given rise to a significant difference with respect to the unqualified audit report. In our opinion, it supports the relevance of the audit beyond the merely quantitative perspective, since, even without being able to carry out an adjustment to the accounts, the mere inclusion of the qualification has modified the decision guidelines.

The objective of testing hypothesis H_{04} is to find out if the estimation of degree of commercial risk is found to be influenced by the nature of the qualifications. For this, the Chi-squared test was applied to all the pairs corresponding to audit reports with qualifications. The results presented in Table 5 indicate that all the combinations, except one, offer statistically significant differences, leading to non rejection of the null hypothesis and, therefore, to the conclusion that in these cases the qualifications described in each report of the pair affect in a different way the degree of commercial risk perceived. The exception is the paragraph of emphasis respect non-compliance affecting the profitability.

It calls the attention that the combination IG/PE offers statistically significant differences, since both audit reports contain a qualification for going concern. In our opinion, one reason can explain this fact: The analysts consider less serious, at the time of assessing the level of commercial risk, the qualification for going concern hidden in a paragraph of emphasis than the qualification for going concern explicitly communicated.

Regarding the combination that has not offered significant differences, that is, PE/INR, a priori, they were expected since there is an audit report that supposes an adjustment to the financial statements. This is clearly observed, as we can see in Annex 1, that the returns on assets and on equity are not the same in this pair. The first one is lower for INR and the second one has negative sign for INR as well.

Evaluation of the relevance of the report in relation to the requirement of additional guarantees (hypotheses H_{05} and H_{06}): The hypothesis H_{05} proposes that the demand for guarantees additional to those normally required does not

Table 6: Contingency table on the demand for additional guarantees and values taken by the variable χ^2 for the comparison between the unqualified audit report and each of the other types of report

Question asked: Would you demand additional guarantees if the real report were ... ?									
	FAV	IG	INRS	PE	IF	INR	Total	χ^2_5	
YES	34	14	16	13	18	8	103	40,59 *	
NO	40	0	2	0	3	0	45		
Total	74	14	18	13	21	8	148		
	FAV	IG	Total	χ^2_1		FAV	INRS	Total	χ^2_1
YES	5	14	19	13,26*		YES	9	16	25
NO	9	0	9			NO	9	2	11
Total	14	14	28			Total	18	18	36
	FAV	PE	Total	χ^2_1		FAV	IF	Total	χ^2_1
YES	6	13	19	9,57*		YES	14	18	32
NO	7	0	7			NO	7	3	10
Total	13	13	26			Total	21	21	42
	FAV	INR	Total	χ^2_1					
YES	0	8	8	16*					
NO	8	0	8						
Total	8	8	16						

*Significant difference at 1%, **Significant difference at 5%, S= Non-significant difference

Table 7: Values taken by the variable χ^2 for the comparison between pairs of reports with qualifications. Question asked: Would you demand additional guarantees if the real report were ... ?

	IG	INRS	PE	IF	INR
IG	—	$\chi^2_1=1.66$ ns	—	$\chi^2_1=2.19$ ns	—
INRS	—	—	$\chi^2_1=1.54$ ns	$\chi^2_1=0.09$ ns	$\chi^2_1=0.96$ ns
PE	—	—	—	$\chi^2_1=2.04$ ns	—
IF	—	—	—	—	$\chi^2_1=1.27$ ns

ns=Non-significant

depend on the type of audit report. As can be seen from Table 6, the value of the Chi-squared statistic for the set of observations leads us to reject the null hypothesis. It should thus be stated that there does exist a relationship between the content of the report and the demand for additional guarantees. This result is also consistent with those obtained in hypothesis H_{01} and H_{03} , that is, the qualified audit reports affect the demand of additional guarantees as commercial risk analysts would demand more additional guarantees for all qualified than for unqualified audit reports. However, it can be surprising that in spite of the existence of an unqualified audit report, thirty-four participants answered that they would demand additional guarantees. This could be interpreted as a particularly prudent commercial policy⁵. The respondents would usually require credit insurance or acceptance of commercial documents.

It was again tested whether significant differences exist between unqualified and qualified audit reports. In Table 6 the results obtained are presented.

In view of the values taken by χ^2 with one degree of freedom, we should reject the null hypothesis, at a 1% level of significance, for all scenarios studied, except for the combination FAV/IF. The other pairs offer statistically significant differences and, therefore, we should interpret this to mean that probability of the risk analysts

demanding additional guarantees is different between an unqualified audit report and another with one of the four kinds of qualifications considered. The only pair, which does not offer significant differences, is that between an unqualified audit report and an uncertainty in respect of taxation audit report. Hypothesis H_{06} is intended to test if the demand for additional guarantees is independent of the nature of the qualification. As can be seen from Table 7, the differences are found to be not statistically significant for all the pairs. Hence, the null hypothesis H_{06} would be accepted, i.e. the requirement for additional guarantees does not depend on the type of qualification. For the combinations IG/PE; IG/INR and PE/INR we could not calculate the Chi-squared test, since in all of them the analysts always decided to demand additional guarantees. In general terms, the guarantees required by the analysts for the qualified audit reports would be: credit insurance, acceptance of commercial documents, bank guarantees and mortgage guarantees.

It can thus be interpreted that all the combinations between qualified audit reports do not give rise to differences in respect of the demands for additional guarantees.

The results obtained for combinations IG/IF and PE/IF do not surprise, since in both pairs the accounting ratios are not modified (Annex 1). However, we would like to emphasise that it would not be incoherent to obtain significant differences, as IG and PE reveal the most serious problem that a company can have, i.e. doubts on the future viability. For the rest of combinations, we expected, a priori, significant differences, since the accounting ratios are different. As regards the pair INRS/INR, also it would be able to be possible that on the analysts decisions were more important the value and the sign of the returns on assets and on equity, as

Table 8: Contingency table on the amount of commercial risk to grant to the possible customer and values taken by the variable χ^2 for the comparison between the unqualified audit report and each of the other types of report. Question asked: According to the content of the audit report, would you modify the amount of commercial credit to grant to the possible client?

	FAV	IG	INRS	PE	IF	INR	Total	χ^2_5	
Yes	7	14	16	13	9	8	67	94,49 *	
No	67	0	2	0	12	0	81		
Total	74	14	18	13	21	8	148		
	FAV	IG	Total	χ^2_1	FAV	INRS	Total	χ^2_1	
Yes	0	14	14	28 *	Yes	0	16	16	28,8*
No	14	0	14		No	18	2	20	
Total	14	14	28		Total	18	18	36	
	FAV	PE	Total	χ^2_1	FAV	IF	Total	χ^2_1	
Yes	4	13	17	13,76 *	Yes	3	9	12	4,2**
No	9	0	9		No	18	12	30	
Total	13	13	26		Total	21	21	42	
	FAV	INR	Total	χ^2_1					
Yes	0	8	8	16 *					
No	8	0	8						
Total	8	8	16						

* Significant difference at 1%, **Significant difference at 5%.

Table 9: Values taken by the variable χ^2 for the comparison between pairs of reports with qualifications. Question asked: According to the content of the audit report, would you modify the amount of commercial credit to grant to the possible client?

	IG	INRS	PE	IF	INR
IG	—	$\chi^2_1=1.66$ ns	—	$\chi^2_1=12,17$ *	—
INRS	—	—	$\chi^2_1=1,54$ ns	$\chi^2_1=8,92$ *	$\chi^2_1=0,96$ ns
PE	—	—	—	$\chi^2_1=11,48$ *	—
IF	—	—	—	—	$\chi^2_1=7,80$ *

* Significant differences at 1% ns=Non-significant

we have indicated above, which would explain why this pair did not offer significant differences at all.

Evaluation of the relevance of the report in relation to the amount of commercial credit to grant to the possible customer (hypotheses H_{07} and H_{08}): In Table 8 are given the results of the testing of hypothesis H_{07} . The intention, firstly, is to test jointly if there are significant differences in respect of the decision to the amount of commercial credit to grant to the possible customer.

As can be observed, we must reject the null hypothesis at a 1% level of significance and conclude, therefore, that the amount of commercial credit to grant does depend on the type of audit report presented by the client in question. In this case, we can also observe that there is a negative relation between the risk assessment and the amount of commercial credit to grant. The analysts revealed that when the qualification is more serious they would modify the amount of credit to grant and it can be supposed that this amount would be lower for more serious qualifications than for less serious or for unqualified audit report.

However, it can call the attention that seven of the participants stated that in presence of an unqualified audit

report they would modify the amount of commercial credit to grant^[6].

The testing of this same hypothesis conducted for the combinations formed between the unqualified audit report and the qualified audit reports gives the results also shown in Table 8.

The results reveal the following. All the pairs do present statistically significant differences, so it can be concluded that all the qualified audit reports will give rise to assume a smaller commercial credit than would be the case if the audit report were unqualified.

In hypothesis H_{08} , it is affirmed that the amount of commercial credit to grant does not depend on the nature of qualification. The results obtained are presented in Table 9.

In the light of the values obtained for the χ^2 for all the pairs analysed, we conclude that the combinations IG/IF, INRS/IF, PE/IF and IF/INR present statistically significant differences at 1%. These results allow us to conclude that the risk analysts would modify the amount of commercial credit to grant, when faced with the four combinations between qualified audit reports mentioned. As we can observe, in these four combinations always appears IF qualification. Given previous results, it can be supposed that the analysts would grant a bigger amount for IF than for IG, INRS, PE and INR qualifications. The other three pairs tested, it is, IG/INRS, INRS/PE and INR/INRS, did not show significant differences, for which it should be interpreted that the analysts do not distinguish between these types of qualifications and, therefore, they would make a similar decision on the amount of commercial credit to grant. The Chi-squared test could not be calculated for the combinations IG/PE; IG/INR and PE/INR.

CONCLUSIONS

As a result of the study that we have presented in this paper, we reach the overall conclusion that the type of audit report does have relevance within the scope of the analysis of commercial operations in Spain and, therefore, affects the actions of the agents who must take the various decisions in respect of the commercial relationships. We cannot reach the same conclusion when we analyse the nature of the qualifications, since the results have revealed that, according to the nature of the qualification, some commercial decisions studied in this work have been affected and other no. These results are consistent with Gwilliam^[33], who indicated that while the denied and adverse opinions significantly affect the decisions taken by users, the effect of the opinions with qualifications will depend on the nature of them.

We support this general conclusion with the following evidence obtained empirically. Firstly, the assessment by these analysts of what is communicated in an unqualified audit report and in one with qualifications is different. The content of the different types of report influences in a different way the following decisions: whether or not to begin commercial relationships; the level of risk assessment; whether additional guarantees are required and whether the content of audit reports modify the amount of commercial credit to grant. The only exception found in this study concerns those audit reports with qualifications for uncertainty in respect of taxation: in this case, the analysts surveyed would take the same decision on whether or not to begin commercial relationships and on additional guarantees required, as they would if the report were entirely unqualified.

Secondly, it has been found that the informative content of the different types of qualification affects in a different way to three of the four categories of decision analysed, that is, the beginning of commercial relationships, the level of commercial risk and the amount of commercial credit to grant, given that there are several cases in which the reaction of the analyst is similar when faced with qualifications of different kinds. Regarding the requirement of guarantees additional to those usually required, none combination offered significant differences between qualified audit reports, indicating, then, that the analysts would demand the same additional guarantees in presence of the different qualifications analysed.

Within this block of conclusions from the empirical study, we would like to point out that some answers from the analysts have been incoherent or surprising. Apart from what 16 out of 74 participants revealed when we had a dialogue with them, these answers can be also due, from our point of view, to the background of the analysts and companies characteristics. In this sense, 37.80% out of the

respondents had four years of experience or less; this might have caused that the least experienced commercial risk analysts made decisions warier than the most experienced, despite the fact that the audit report was unqualified. This could explain, for instance, why 34 respondents out of 74 stated that they would require additional guarantees when the audit report were unqualified or 7 out of the respondents would modify the amount of credit to grant also when the audit report were unqualified, in addition of what some respondents told us. Another point to be noticed is the industry of the companies. As we can see in the description of the study sample, the companies belong to industries that are different and, therefore, they have different risk policies as well, that is, some companies will be warier than other. To this comment, we can also add the fact that 79.9% of the companies were not listed, what can explain why some companies would be able to be warier than other since they get financing from other sources different to capital markets. These companies will have to guarantee that the commercial risk and the fact that some companies do not pay back the credit are within the companies limits.

On the other hand, we have reached the conclusion that the return is a factor equal or much more important on the commercial decisions than the solvency. In two cases where the qualification for non-compliance affecting the profitability were compared with qualification for non-compliance affecting both solvency and profitability, the analysts decisions were the same. In other words, it has been more important the sign of the return than that of the solvency.

In addition, we would like to emphasise the role that the audit report can play for the commercial risk analysts. Some analysts answers contribute to speak favourably of relevance of the audit report, since as commented in study sample section, 60% of those surveyed affirmed that, when any qualification were made in the audit report, this led them to investigate the particular problems that the qualification brought to light. In this case, the relevance would not be expressed in terms of an immediate effect on a specific credit decision, but rather as the possibility that, as a consequence of the investigations that may be set in motion by the report, it could have a future effect.

LIMITATIONS

This was a study of the reactions of commercial risk analysts to one unqualified audit report and one qualified, analysing five qualifications (going concern, non-compliance affecting both the profitability and solvency, paragraph of emphasis, uncertainty in respect of taxation and non-compliance affecting the profitability). The results cannot be generalised to other

forms of audit reports (disclaimer, adverse or other type of qualifications), nor can they be generalised to other types of audit reports readers.

Another limitation in interpreting the results is the low number of responses. This could reflect the effects of mixing responses from commercial risk analysts working in companies that differ widely in size and internal commercial policies.

The experiment was conducted by mail and thus was subject to the limitations of a mail survey. There is a possibility of nonresponse bias since any test was applied to compare early vs. later responses. However, as we have already pointed out, the tests used in prior research in order to test for nonresponse are limited and have not revealed significant differences.

Finally, the research was conducted with commercial risk analysts in Spain and using audit opinion forms prescribed in Spain. For this reason, caution should be exercised in extrapolating these results to other countries.

NOTES

- Although this practice is obviously a non-compliance with Auditing Standards, it is sometimes used to hide or lessen the effects of a qualification and it has been shown that it happens^[14], for which the analysts, independently of the degree of adjustment from the audit report to the standard, must decide based on this paragraph.
- Spanish auditing law lays down the general provision for obligatory auditing, according to which the annual accounts medium-size and large companies must be audited. For the implementation of this normative, the Spanish Institute of Accounting and Auditing of Accounts issued the Technical Standards for Auditing. These include the technical standard for audit reports^[35]. According to this technical standard, four types of opinion can be reported: 1. An unqualified opinion; 2. A qualified opinion (due to any of the following: limitations in the scope, errors or non-compliance with generally accepted accounting principles and standards, uncertainties and changes in generally accepted accounting principles and standards), incorporating the expression except for 3. An adverse opinion (due to very significant errors, non-compliance and changes in generally accepted accounting principles and standards) and 4. A denied opinion (due to very significant limitations in scope and/or uncertainties). This study focuses on unqualified opinion and qualified opinion. Except going concern opinion, the four remaining qualified opinions analysed in

the study are among the most frequently occurring in Spain^[36,37]. Although going concern opinion is not as common as other, Spanish auditors issued 48 going concern opinions to big Spanish companies from 1991 to 1995^[36].

- Although we have not applied any test in order to test for nonresponse bias, Oppenheim^[38] demonstrated that late respondents respond similarly to nonrespondents. In addition, some prior research^[4,39,40] has shown that tests of early vs. later responses are limited and provide limited assurance that responses are representative of the entire population. In spite of this fact, these studies did not find significant differences when comparing early respondents to later respondents.
- Given this percentage, we had a dialogue with those respondents who stated the company's name, concretely with 16 out of 74 participants, in order to know why they do not read or sometimes read the audit report. The remaining 58 did not indicate the company's name, so it was impossible to keep in touch with them. 9 out of 16 respondents stated on the questionnaire that they do not read or sometimes read the audit report. The reasons given by the analysts were the following: they do not read or sometimes read the audit report because they believe that the audit reports are negotiated between the auditor and the company, that is; they have doubts about the auditor independence. Relative to this, the analysts also told us that when the audit reports were signed by one of the second tier-auditing firm, they considered that the audit report had a lower credibility because in these cases they presume that exist a mixed effect of a lower technical capacity or a lower independence. The remaining 7 respondents always read the audit report.
- The same number of participants who do not read or sometimes read the audit report, that is, 9 out of 16 respondents with whom we had a dialogue, pointed out on the questionnaire that they required additional guarantees, despite the fact the audit report were unqualified. According to them, it is because the audit report is not enough to guarantee that the company would pay back the credit (except when the financial situation of the company requires a going concern opinion, there are weak financial situations which give rise to unqualified opinions), because unqualified audit reports are sometimes negotiated between the auditor and the company or because it is the company policy. The remaining 7 out of 16 participants would not require additional guarantees.

- Only 1 out of 16 participants with who we had a dialogue, would modify the amount of the credit to grant, although the audit report were unqualified. This analyst was one of who would require additional guarantees when the audit report is unqualified, pointing out the same reason, that is, unqualified audit reports are sometimes negotiated between the auditor and the company.

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