

The Impact of Audit Quality in Reducing the Creative Accounting Practices and Activating External Investments (An Applied Study to the Iraqi Stock Exchange)

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Abstract

The economic and the technological developments in the investment environment have posed serious challenges for reporting, measuring, and presenting accounting information. Creative accounting poses a major threat to the interests of shareholders and beneficiaries of the firms' financial reports resulted from the accountants' manipulations of the methods, procedures and policies exploiting their knowledge and experiences, with the accounting standards, to manipulate figures to improve the outlook of the economic unity and to give misleading data. Since auditors are regarded as shareholders and stakeholders' agents in expressing an impartial technical opinion on the financial statements, their liability is not to disclose such practices and procedures at a time when the conduct of the profession should be in line with the objectives of the users of the financial statements. Creative accounting practices are among those topics that have preoccupied practitioners, professionals, and investors due to the negative impacts they have on companies. The management conduct of information concealment, or false submission, is often attributed to the inclusion of a financial reporting, which in return creates distrust to the dealers and investors, that consequently affects the foreign investment negatively in the Iraqi environment. Hence, the research firstly aims to explain the impact of audit quality in reducing of creative accounting practices and how to encourage the investors.

Keywords

Creative Accounting, Amortization Methods, Iraqi Stock Exchange.

Introduction

Audit quality represents a necessary requirement to all auditing parties involved. The auditor's concern is to achieve a reporting completion process for a credibility. Whereas the management, with its expertise, ensures that the audit process is conducted in a high

quality to give confidence to the financial reports prepared. The beneficiaries want the audit to be conducted with a high quality in order to ensure the accuracy and fairness of the financial information contained in the audited lists, which they will actually rely on when making their decisions. The professional organizations seek to promote the quality of audit to preserve the interests of all parties through the issuance of standards governing the profession and the assurance of their application. Some corporates departments practice creative accounting by exploiting the various alternatives available in the accounting policies, provided by the accounting standards of cooperates, in the preparation of the financial statements in order to improve their work environment outlook; which in return affects the quality of the information shown in those statements and their credibility. Consequently, such a corporates department conduct misleads the profession of accounting and audit.

The quality of auditing has an effective role in reducing illegal practices because of its obvious effects on the quality of the services it provides. Moreover, the quality audit is considered as an effective instrument in developing and practicing the profession. In order to keep such a profession in line with the developments, many professional bodies have started to set standards and measures on the quality of the audit process to provide professional services that are marked by the highest degree of efficiency and effectiveness. This is reflected in raising the confidence of users of the financial statements and raising the level of professional accountants and auditors for the purpose of revealing and limiting the illegal accounting practices.

Research Methodology

Problem of the Study

In the light of intensive competitions, accounting information is necessary to achieve excellence in the competitive position of the company by increasing the value of the company in the market and motivating external investors to invest. The audit quality is a necessary requirement for all parties benefiting from the audit process. Additionally, accounting information is an effective factor for many accounting practices, including creative accounting practices, for affecting the published financial statements so as to reflect the value of shares in the stock market and thus to achieve fame and returns of management as well as to encourage attracting the investors when the corporate income is consistent from time to time. The paper problem can be summarized in the following questions:

1. What is the impact of external audit quality on the activation of foreign investments in the Iraqi environment?
2. What is the impact of the quality of external audit in reducing the effect of creative accounting in the financial statements issued by shareholders companies listed in the Iraqi Stock Exchange?
3. What is the impact of the practices of creative accounting methods on the relationship between the quality of external audit and the activation of external investments?

The Objectives of the Study

The research paper aims at achieving the following objectives:

1. Stating the impact of audit quality on creative accounting practices and the ways to reduce them.
2. Shedding the lights on the external auditor's responsibilities of revealing and identifying the methods and procedures manipulated by the companies' managements under what is so called 'the creative accounting'.
3. Stating the impact of audit quality of the published information in the companies' financial statements, the reflection of that impact on the shares values in the stock markets, and additionally encouraging for the attractions of investors.

The Hypotheses of the Study

H1 There is no correlation between the external quality audit and the creative accounting methods.

H2 There is no correlation between the creative accounting methods and external investment.

H3 There is no correlation between the external quality audit and external investment.

The Significance of the Study

The significance of the research stems from its important contribution for revealing and determining the role of the external audit in the light of the weak auditing environment of most firms, where the creative accounting methods are considered as the main issues that have preoccupied the interests of the practitioners, the technical directions, and investors due to the negative impacts the issues have on the companies. What the financial reporting includes from the information is often resulted with the endeavors of the management to conceal information or to submit it in a shading way due to credibility destabilization of the dealers and investors which will negatively be reflected on the

attractions of external investments in the Iraqi environment. Additionally, the Iraqi Stock Exchange credibility heavily relies on the quality of the applied accounting information and standards.

Audit Quality and Its Requirements

Audit Quality Definition and Notion

There is no specific comprehensive definition to the quality of audit due to the different ideas and concepts from which people start to determine the concept of quality in general, and the quality of audit in particular. In terms of language, the word ‘Quality’ is derived from Latin ‘Qualitas’ which means the nature of someone or something and the level of the validity. Concerning audit quality, it has been addressed by many researchers by linking it with the variables that would affect that quality. DeAngelo (1981) defines the quality of audit as ‘the joint probability that an auditor will both discover and report a breach in the client’s accounting system.’ Moreover, the quality of audit has been also defined as ‘the process that brings more credibility to financial reports’ (Tonh and Wong, 1993). In term of the relationship between the client’s internal audit system and the quality of audit, it has been defined as ‘the ability of the auditor to detect weaknesses in the internal control system, make recommendations for addressing them, or reduce them, and the possibility of maximizing the potential benefit of the client’s company.’ (Othman and Jameel, 2012).

Based on the literature review, the quality of the audit is the process that aims to provide the professional attention required by the auditor using modern methods and techniques of auditing in order to detect and report any material misstatement or omission of the financial statements in light of the relative importance, and to ensure the extent of the economic unit's compliance with generally accepted accounting principles in the preparation of the financial statements and that they have been consistently applied from year to year in order to give credibility to the financial reports submitted by companies.

The Significance of Audit Quality

- Although the audit quality is difficult in its nature, it is an essential requirement for all beneficiaries of the auditing profession due to following reasons (Essa, 2008).
- The external auditor should consider the auditing process is carried out with the highest quality manner to guarantee as maximum credibility the reporting as possible.

- The management of the company attempts to control and audit its financial statements which requires implementing auditing process in the highest quality as possible.
- The professional organizations believe that achieving quality in the implementation of financial auditing functions ensures that the audit profession fulfills its responsibilities to all concerned parties.

Auditing Quality Requirements

The increase of the social awareness of the external auditor's significant role can create an appropriate environment for achieving professional developments by developing laws, regulations and standards that govern the profession and provide the necessary requirements and conditions for the preparation of the auditing members. Below is standardizations for the auditing quality improvements as illustrated by the Association of International Accountants (AIA) (2001).

Personal Requirements

- Professional Requirements: The professional principles commitments that the firms auditors be confined to follow (i.e., independency, neutrality, objectivity, privacy, and professional conduct).
- Skills and Efficiency: The auditing firms must resort to individuals have received and maintained technical standards and professionalism required to carry out their duties with due care.
- Preparing programs to meet the requirements of the audit firms with individuals of high expertise in various fields.

Planning Requirements

They are categorized into the following:

- Tasks Assignments: Auditing must be committed to individuals with high levels of technical training and professional competence required.
- Supervision: There should be supervision, guidance, and follow up to the business on all levels to provide a reasonable confidence that the work performed is in accordance with the appropriate quality standards.
- Consultation: There should be a consultation within the auditing firm with the individuals of the proper expertise when necessary for diagnosing and considering potential issues.

Monitoring and Follow-up Requirements to the Policies and the Procedures of Audit Quality Process

- Specifying the scope and the specification of the auditing programs.
- Taking actions for auditing results delivery to all the appropriate administrative levels by imposing adopted or planned auditing procedures, and by comprehensive follow up to the audit quality system.

Code of Ethics

Code of Ethics refer to fundamental professional principles for the process of reviewing and monitoring historical financial information and the assurance that the process and the services conducted are in compliance with these principles. The code of ethics underlying the professional auditing include: integrity, objectivity, professional competence and due care, confidentiality, and professional behaviour.

Methods Used in Auditing the External Auditor's Performance Quality

The importance of audit quality of the external auditor's performance stems from the significance of the role played by the external auditor as s/he reports a brief of the auditing work embodied in form of neutral technical opinion and impact of this opinion on various parties within the community. Therefore, the professional parties concerned with establishing Quality Control Standards (OCS) as measurement for evaluating the practitioners' profession. Moreover, the professional concerned parties have established methods of inspecting the audit quality of the external auditor's performance. These methods can be noted as follows:

Performance Review by Specialized Inspection Bodies

The *Board of Audit Profession* selects a specialized committee called the *Follow-up and Inspection Committee*, which conducts sudden inspection visits to the auditors' firms, examines the policies and procedures followed during the performance of the work of the office, and determines the compliance of the office with instructions. In case of violations, they will be reported to the *Disciplinary Committee* for examination and taking fundamental actions against the auditing firm.

Concurring Partner Review

This method is based on the fact that one of the practitioners examines and verifies all the practical steps of the audit conducted by a colleague in the same audit firm. This review

must be carried out before the report is prepared by the head of the audit team (Arens and Lubeck, 2005).

Peer Review

The audit firm of the external auditor reviews the auditing firm of a colleague throughout examining the colleagues' compliance to public policies, the professional code of conduct, and as examining the quality standards of professional performance. This sort of examination has many advantages to the profession because a peer review is a tool for ensuring the implementation of the standards of quality audit performance in the audit firms. Peer review also contributes to the improvement of the performance of professional practitioners, which is reflected in raising the level of the profession by providing its practitioners with high quality services. Moreover, the peer examination improves the reputation of the audit firm and contributes to the effectiveness of the audit process, which is reflected in the low probability of auditor's exposure to legal liability as long as the auditor works in a conformity with the auditing accepted standards (Arens and Lubeck 2005).

Based on the above literature review, it is important to implement a periodical inspection to the performance quality systems. The periodical inspection varies according to the size of the audit firm and the policies and procedures adopted by the auditor. Moreover, the periodical inspection depends on the nature of the services provided by the organizational structure, taking into account the benefits achieved by the system of quality audit performance compared to the expenses the auditor provides for applying these procedure and policies.

Risks Arising from Audit Quality

There are two types of risk arising from non-performance of high quality audit:

1. Risks related to audit firms or companies, resulting from supply side:
 - Declining the reputation of the firms or companies of audit.
 - Decreasing the revenue the audit firms or companies can earn.
 - The possibility of exposing the firms or companies of audit to the legal accountability.
 - The possibility of the auditor's loss of independence with the customer audited and controlled.

2. Risks associated with the users of financial statements, such as investors, creditors, and other parties. The failure to attain high quality audits leads to low level of detectability to the fraud misinformation in the records and the financial statements of management. Therefore, their reliance on the neutral external auditor's report resulted from a low quality auditing process will result to taking incorrect or wrong decisions (Al-Qaiq, 2012).

Creative Accounting

The Concept of Creative Accounting

The concept of creative accounting is used to describe cases of showing income, assets and liabilities of the economic unit in an unreliable and unrealistic way, which led to many financial collapses and scandals in many major international companies. Although the definitions of creative accounting vary in different accounting literature, they all share the same economic content. Below is a set of creative accounting concepts based on different orientations:

- From the professional accountant's point of view, it is verified that the accounting process consists of dealing with many matters of judgment and of resolving conflicts between competing approaches to the presentation of results of financial events and transactions. This flexibility provides opportunities for manipulation, deceit and misrepresentation. These activities-practiced by the less scrupulous elements of the accounting profession have come to be known as *creative accounting* (Nasar, 1993).
- From the investment analyst's point of view, creative accounting represents the apparent growth in profits that is the result of accounting sleight of hand rather than genuine economic growth (Smith, 1992).
- Whereas creative accounting, from academic accountants' perspective is the transformation of financial accounting figures from what they actually are to what prepares desire by taking advantage of the existing rules and for ignoring some or all of them.

Management's Motives for Using Creative Accounting Methods

The management's motives for using creative accounting methods vary, but the most important sorts of them are the following:

1. The positive impact on the reputation of the company in the market: in order to improve the financial values related to the performance of the business.
2. Impact on the share price of the company in the financial markets: in order to maximize the financial values and then improve the prices of shares of these companies in the financial markets.
3. The increased borrowing from banks: This will have a positive impact on the credit decision making process.
4. For tax manipulation purposes: through the reduction of profits and revenues and increase expenditures by reducing the tax deductions resulting from them.
5. Improving the financial performance of the establishment to achieve personal interests: by improving the values of the enterprises it manages to reflect a positive reputation of its performance for the personal purposes by improving the image of the administration to the board of directors (Mulford & Comiskey, 2002).

Methods of Creative Accounting in the Financial Statements

Methods of Creative Accounting in the Income Statement

According to (Schilit, 2002), the most important methods used to manipulate the income statement under creative accounting are:

1. Recording Revenue Prematurely or of Questionable Quality: According the operating procedures, the revenue is recorded after the completion of the mutual benefit process. In this way, the revenue from the sale is recognized and calculated prior to completing all services on the ground and before the completion of the mutual benefit.
2. Recording Fictitious Revenue: It is represented by recording revenue for simulated sales.
3. Increasing Income with One-Time Gains: This is represented by the attempt of management of certain company to increase its revenues once during a specific financial period. These practices give a positive image of the company's management by increasing its revenues and profits while performing inefficiently. This kind of revenue is usually dealt with in indication that it is the result of non-core and non-operating processes.
4. Shifting Current Expenses to an Earlier or Later Period: This type of manipulation is related to asset accounts as it is known that the expenses incurred in carrying out the business may lead to short-term benefits such as rents, salaries and advertising that are directly deducted from revenues that may result in long-term benefits such

- as buildings and machinery which are assets that their depreciation deducted over long term period, at the time the benefit has already been realized. Sometimes, certain items of these assets become useless and are therefore recorded as expenses directly deducted from income.
5. **Failing to Record or Improperly Reducing Liabilities:** Sometimes, managements of some companies conduct private liabilities cancelations for special purposes. Such cancelations conduct includes judicial liabilities cancelation or the cancellation of purchase commitment disclosure of changes in the accounts of commitments.
 6. **Shifting Current Revenue to a Later Period:** This method aims to reduce current profits and transfer them to a later financial period that is more needed. This method is usually used when the company's current year conditions are excellent. It transfers these profits to future periods that the company management believes can be difficult (Howard, 2002).
 7. **Shifting Future Expenses to the Current Period as a Special Charge:** These methods are used in times when the companies face challenges due to business downturns and other setbacks which instigate the managers to change standards in the accounting records to counter that in the hope of a better future and reducing the burden at the current period relying on a good future expected.

Methods of Creative Accounting in the Balance Sheet

The following is a presentation of the methods of creative accounting in the balance sheet:

1. **Intangible Assets:** In this regard, intangible assets, such as trademarks, are overvalued as well as the accounting recognition is overstated violating the rules and regulations of the international accounting standards such as the recognition of unquoted goodwill, and the amortization methods used to reduce these assets.
2. **Tangible Assets:** In this respect, there is no adherence with the historical cost principle in the inclusion of the value of the tangible in the balance sheet, and also the conventional asset depreciation ratios are manipulated by subtracting them from those used.
3. **Traded Investment:** There is manipulation of the market prices for valuing the securities in the portfolio, as well as there are unjustified deductions in the price reduction.
4. **Monetary Base:** There is no disclosure to the restricted monetary items, and manipulation of exchange rates used in translating monetary items applicable from the foreign currencies.

5. Accounts receivable: Manipulation here is represented by non-disclosing impaired debt for the purpose of reducing the provision for doubtful debts, and making deliberate errors in the classification of accounts receivable from classification of long-term receivables as current assets with a view to improving the liquidity of the enterprise.
6. Long-term investments: by changing the accounting methods used in accounting for long-term investment, from cost method to equity method.
7. Potential Assets: The potential assets are approved before they get ascertained, such as the approving revenue expected to be collected from a customer before a judgment is rendered.
8. Current Liabilities: such as non-inclusion of due installments during the current year of long-term loans under current liabilities, with the aim of improving liquidity ratios.
9. Long-term liabilities: such as long-term loans before the budget announcement, to be used to repay short-term loans and to improve liquidity ratios.
10. Inventory: In this item, the manipulation and practice of creative accounting methods are concentrated on including stocks of stagnant and obsolete goods in addition to manipulating the prices of their valuation and unjustified changes in the stock pricing method.
11. Shareholders' equity: such as the addition of realized gains from previous years to net profit for the current year, instead of being treated as retained earnings as an item of previous years (Oliver, 2003).

Methods of Creative Accounting in Cash Flow Statements

The cash flow statement presents all cash inflows and outflows in terms of sources and utilizations over a period of time. The purpose of this list is to assist investors, creditors, learners and others in cash analysis by providing appropriate information on the sources of cash flows and payments over a given period of time. The followings are presented opportunities for the manipulation with the accounting values using creative accounting techniques in the cash flow statement:

1. The accountant classifies operating expenses as investing or financing expenses and vice versa. These procedures and practices do not affect nor change the final values.
2. The establishment may also pay for capital development costs and record them as external cash inflows moving them away from the operating cash outflows. Consequently, these practices increase the inflows of cash.

Operational cash flows can also be manipulated to partially evade paying taxes by making adjustments to operational cash flows, such as reducing the gain on sale of investments and certain equity. Similarly, unfinished operations affect the operational cash flows through the elimination of tax effect on these operations from the operating cash flows, as any cash received is approved. As a result of the unfinished operations or their disposal, the cash received is considered to an outcome of investment activities. Therefore, during the calculation of operating cash flows, the effect of the gain or loss on incomplete operating operations is eliminated or disposed from the net income (Mulford & Comisky, 2002).

Methods of Creative Accounting in the Statement Changes of Owner's Equity

The statement of changes of owner's equity is considered as the link between the statement of income and the statement of the financial position (balance sheet), and it is determined by monitoring and following-up the changes in the equity items from the beginning of the financial period to its end, and its presentation is actually based on the accrual basis. All elements of this item are subject to the use of creative accounting practices through fraudulent changes in capital increase or reduction, as well as the acquired capital and the calculated capital, which are used to recalculate previous errors or losses of prior options and foreign currency balances (Arens, 2006).

Accordingly, the fairness and the accuracy in providing correct and transparent information just in time to all the company stakeholders enforce and enhance the extent of the confidence in the management systems of the company the direction of its employees, and the decision-making stages based on the information disclosed in the financial statements.

The following are the most important procedures and tests carried out by the auditor to reduce the effects of the use of creative accounting methods by the management to protect the stakeholders' rights in the statements of income and of balance sheet:

- A. Procedures and tests applied by the auditor to reduce the effects of creative accounting in the income statement: the management resort to the creative accounting practices on the input elements (revenues and expenses) to improve the profit by showing unrealized profits by inflating sales or reducing expenses or both, in order to improve the financial ratios that include and calculate the sales figures, costs and net income as profitability ratios and activity efficiency. Table (1) illustrates the most important accounting procedures related to the income

statement, the purpose of their implementation, and countermeasures the auditor should apply.

Table 1 Creative Accounting Methods in the Statements of Income of Balance Sheet and the Auditor's Countermeasures

Item	Management's objective of creative accounting methods	Auditor's countermeasures
Sales	Improve the sales figure of the statement in the income statement by increasing it in the simulated sales. Among the indicators of those practices is the extraordinary increase in the sales size compared to prior years.	Verify the sales invoices, especially for transactions executed with related parties.
Cost of Goods Sold	Reduce the cost of goods sold in the income statement to increase profits.	Verify that the sales are real and not simulated
Special and Extraordinary Items	Improve the profitability of the company from its operating processes through non-operating activities.	Excludes the profit of those items from operating profit

B. The auditor's procedures and tests applied to reduce the creative accounting effects on the balance sheet:

The management utilizes creative accounting methods on the elements of the balance sheet to improve the company's financial position by either inflating the assets values, or reducing the liabilities values, or both for the purpose of improving the presentation of the assets derived ratios such as liquidity or profitability ratios, etc. Table (2) below demonstrates the most important creative accounting methods on the balance sheet, the aim or their implementation, and the countermeasure the auditor should adopt:

Table 2 Creative Accounting Methods on the Balance Sheet, The Aim of Implementation, and the Auditor's Countermeasure

Item	Management's objective of creative accounting methods	Auditor's countermeasures
Cash	Improving the liquidity ratios.	Excluding restricted cash when calculating liquidity
Current investments	Maintaining /Reducing the currents assets values to improve liquidity ratios.	Validating the prices used.
Accounts Receivable	Maintaining /Increasing the values of the accounts receivable for improving liquidity ratios.	Requesting accounts receivable confirmation and verifying the provision ratio of the total accounts receivables.
Inventory	Increasing the inventory value to raise the value of current assets and to affect the liquidity ratios.	Inspecting inventory reports and verifying the actual presence of items in warehouses.
Long-Term Investments	Affecting the investment accounts in the records of the company and the result of their businesses by showing only the shares in profits without the loss.	Verifying the change and the consequences on the statement of income and the balance sheet by external auditor's report.
Long-Term Assets	Improving the company's profits by including revaluation surplus or by reducing depreciation expense.	Verifying the depreciation rates and modifying its expenses.
Intangible Assets	Increasing the value of the Company's assets to improve the rations of the financial relevance as well as to improve the profit figure by reducing the amortization expense of these assets.	Validating that the basis of evaluating and modifying the value is according the correct operating standard procedures.
Current liabilities	Reducing the value of current liabilities to improve liquidity ratios.	Validating the basis followed in approving the current liabilities and recalculating the liquidity ratios.
Long-term liabilities	Improving the liquidity ratios and profits of the company by including unearned revenues of bonds amortization.	Validating the procedures for obtaining long-term loans and make necessary adjustments.
Shareholders' equity	Improving the company's business outcome by incorrectly including unrealized gains from previous years, and to exclude losses arising from exchange rate fluctuations associated with transactions in foreign currencies.	Modifying the current year profits, their relevant ratios, and the ratios of their distributions.
Contingent assets and Contingent liabilities	Improving the financial ratios by increasing the assets and reducing the liabilities.	Auditing the impact of contingent assists verification (prior to the availability of the approval conditions) on the relevant financial ratios, and modifying them conveniently.

The Iraqi accounting environment is a part of the international accounting environment, and therefore it should step out from the locality to the internationality in applications to the international accounting standards, especially after Iraq has a serious desire to work in the market economy, as well as to attract investors after their confidence and reliance on

the information included in the financial reports of companies operating in Iraq, and the possibility of providing a unified reading of the financial reports, and the possibility of providing unified readings to the financial statements to give credibility to the accounting information so as to be reliable and dependable, as the competent auditor usually attempts to obtain sufficient and appropriate evidence to prove that there were no distortions or errors in the financial reports due to creative accounting practices.

Practical Perspective

An Analytical Study of the Results of the Questionnaire

Methodology

In addition to the analytical descriptive approach that the study dealt with in its theoretical framework, this study has an applied field dimension related to the relationship between external audit quality and creative accounting and its effect on investor's margin. The study is an applied exploratory one on the Iraqi accounting environment. The samples of the study includes a group of selected Iraqi companies listed in the Iraq Stock Exchange, brokerage companies, financial divisors working in the companies listed in the Iraqi Stock Exchange, external auditors who audit the accounts of these companies, accountants in the federal financial auditing bureau and other accountants in some other various companies and academics in some Iraqi universities in the field of accounting and auditing. Through the questionnaire prepared for the practical part of this research study, the participants in the sample will be asked to give their views on this relationship. The purpose behind including academics and professionals in the sample of the study is actually to mingle the views of the two parties. A total of (80) questionnaires were distributed, (70) were retrieved and 3 were excluded from the analysis due to the lack of serious answers to their questions. Thus, the number of the analyzed questionnaires is (67) one. The data was analyzed using the statistical program (SPSS).

Describing the Population of the Study

The researcher has divided the population of the research into four categories, representing the variables of study. The categories of the study sample are as follows:

CATI. Iraqi companies listed in the Iraq Stock Exchange. This category represents the variable of the methods of creative accounting as it takes place in the accounts of the companies and serves the departments and the issuer of financial statements.

CAT 2. Brokerage companies and financial advisors working in the Iraqi Stock Exchange. This category represents the variable of the investor's margin of safety, as it contributes significantly to estimating the real stock price, advises investors and gives them a margin of safety of any potential risks that they may face in the future.

CAT 3. External auditors who audit the accounts of the Iraqi shareholding companies in the Iraqi Stock Exchange. The reason for chosen this category is to represent the external audit quality variable.

CAT 4. Academics in some Iraqi universities in the field of accounting and auditing. The reason for their inclusion in this category is to mingle the views of the academics and the professionals.

Table 3 Sample Study Population

Data	Distributed Questionnaires		Retrieved questionnaires		Cancelled Questionnaires		Valid questionnaires		
	Frequency	*%	Frequency	*%	Frequency	*%	Frequency	*%	**%
Listed Companies	20	25%	18	90%	1	5%	17	85%	25%
Brokerage Companies	20	25%	18	90%	2	100%	16	80%	24%
External Auditor	30	38%	24	80%	--	--	24	80%	36%
Academics	10	12%	10	100%	--	--	10	100%	15%
Total	80	100%	70	87.5%	3	3.7%	67	83.7%	100%
* Ratio to distributed questionnaires									
** Percentage of valid questionnaires as a whole.									

Table (3) shows the number of distributed questionnaires (returned and received). The returned questionnaires are (70), about (87.5%), which is a high percentage. The percentage of the retrieved questionnaires is (83.7%) out of the total distributed questionnaires. Also, table indicates that the percentage of external auditors involved in the study the highest as it is researched to (36%) out of the total the retrieved questionnaires percentages. Whereas, the percentage of the listed companies in the Iraqi Stock Exchange is (25%) and the brokerage company's percentage is (24%), and the percentage of the academic participants is (15%). This means that the sample of the study belongs to different sectors concerned with accounting and auditing who have experience.

Table 4 Concepts of the Study Axes

The First Axis: External Audit Quality: <i>It represents the following:</i>		The Second Axis: Creative Accounting: <i>The followings are considered as creative accounting methods:</i>		The Third Axis: Investor's Margin of Safety: <i>The investor conducts the following measures to make an investment decision based on the margin of safety.</i>	
1	Auditor's compliance with auditing standards and professional ethics.	1	Preparing invoices for fake transactions.	1	The investor studies the financial markets and picks the appropriate market for him.
2	Discovering and disclosing material misstatement of financial statements	2	Counting unfair allowance for price decline.	2	The investor studies the market efficiency and the strength of his response to any new information.
3	Increasing the safety and reliability of users of financial statements.	3	Accrediting low rates of allowance for doubtful account to total debtors.	3	The investor is interested in choosing the financial sector that he can understand
4	Increasing the quality of information and data in the published financial statements.	4	Including operating profit as gain from extraordinary items.	4	The Investor studies all the companies listed in the sector chosen by him and the degree of competition.
5	The size of the firm audit that provides the service	5	Non-disclosing the restricted cash and its exclusion from liquidity ratios.	5	The followings increase the investor's safety and tranquility:
6	Audit Firm Reputation	6	The adoption of incorrect exchange rates for the translation and settlement of transactions in foreign currency.	6	The quality of financial and accounting reports and the absence of any errors or manipulations with the material.
7	Audit firm industry specialization	7	The adoption of unfair market prices to assess the securities portfolio.	7	Quality of accounting information properties.
8	Audit firm fees	8	Manipulation with the short and long term receivables classification.	8	Quality of the external auditor's report.
9	Auditing staff independency of profession and decision	9	Listing the damaged goods within inventory	9	The auditor's professional care and his discovery of the errors and fundamental manipulations.
10	Audit team experience	10	Inflating the market value of commodity inventories compared to current market prices.	10	Disclose in the financial statements the true financial position of the company and its collection of due and realized profits previously.
11	Audit firm size is an auditing concern affects the auditing quality.	11	Change the method of disposal of commodity inventory without acceptable justification.	11	Obtaining an expected return from a previous deal.
12	The internal control system of the company and its strength, and the internal control of operations.	12	Changing the consumption method without acceptable justification.	12	The consistency of the level of profits achieved by the company, which helps to determine the margin of safety.
13	Level of awareness of the user of the financial statements and his understanding of the items of the financial statements.	13	Overvaluing the fair value of the financial assets.	13	Historical stock price movement in the financial market.
14	Technological progress and the scientific methods of audit firms follow.	14	Calculating the amortization of debt in an inappropriate manner with international accounting standards.		
15	The closest estimate of the expectations of the users of the financial statements of the performance of the audit.	15	Non-inclusion of due payments from loans.		
		16	Obtaining long-term loans before the end of the year to support the working capital.		

Statistical Processing Used in Data Analysis

The researcher has used adopted important statistics on the sample data studied, namely the creation of the arithmetic mean and the standard deviation as shown in Table (5) and for each of the three axes.

Table 5 The Arithmetic Mean and the Standard Deviation of the Categories of Study Axes

Standard Deviation	Arithmetic Mean	Item	Standard Deviation	Arithmetic Mean	Item	Standard Deviation	Arithmetic Mean	Arithmetic Mean
.696	4.00	***INSA1	.680	4.19	**CRAC1	.735	4.22	*AUQU1
.651	4.00	INSA2	.621	4.09	CRAC2	.687	4.27	AUQU2
.674	4.03	INSA3	.572	4.28	CRAC3	.630	4.24	AUQU3
.649	4.06	INSA4	.600	4.13	CRAC4	.730	4.27	AUQU4
.737	4.18	INSA5	.600	4.13	CRAC5	.661	3.96	AUQU5
.659	4.07	INSA6	.668	4.09	CRAC6	.677	4.10	AUQU6
.631	4.10	INSA7	.673	4.18	CRAC7	.613	4.33	AUQU7
.628	4.00	INSA8	.574	4.06	CRAC8	.533	4.33	AUQU8
.759	4.00	INSA9	.701	4.19	CRAC9	.614	4.04	AUQU9
.674	4.00	INSA10	.618	4.16	CRAC10	.625	4.06	AUQU10
.578	4.30	INSA11	.638	4.04	CRAC11	.733	4.09	AUQU11
.685	3.99	INSA12	.628	4.00	CRAC12	.699	4.10	AUQU12
.708	4.12	INSA13	.565	4.12	CRAC13	.596	4.09	AUQU13
.400	4.066	INSA	.672	3.94	CRAC14	.596	3.91	AUQU14
			.609	4.15	CRAC15	.716	4.13	AUQU15
			.623	4.22	CRAC16	.350	4.143	AUQU16
			.392	4.126	CRAC			AUQU17

*AUQU: Audit Quality. **CRAC: Creative Accounting.,
 ***INSA: Investor's Safety Margin.

Table (5) shows that the highest arithmetic of the first axis is for the seventh and the eight items, but the eighth items has a lower standard deviation. This means that the answers of the sample to that item is closer to the seventh item, while the lower arithmetic mean is for the fourteenth item. The highest arithmetic mean for the second axis is for the third item, while the lower arithmetic mean is for the fourteenth item. The highest arithmetic mean for the third axis is for the eleventh item, while the lower arithmetic mean is for the twelfth item. As for the standard deviation, it is close to all items indicating that the respondents are in agreement about the direction of the response to the items.

Frequencies and their Rates

Table 6 The Frequencies and their Rates of the First Axis Items (Quality of External audit)

Axis		Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree
External Audit Quality	frequency	0	0	161	539	305
	percentage	0	0	16%	54%	30%

Figure (1) below shows the first axis frequencies rate as it is clear that the answers tend to agree on the items of this axis:

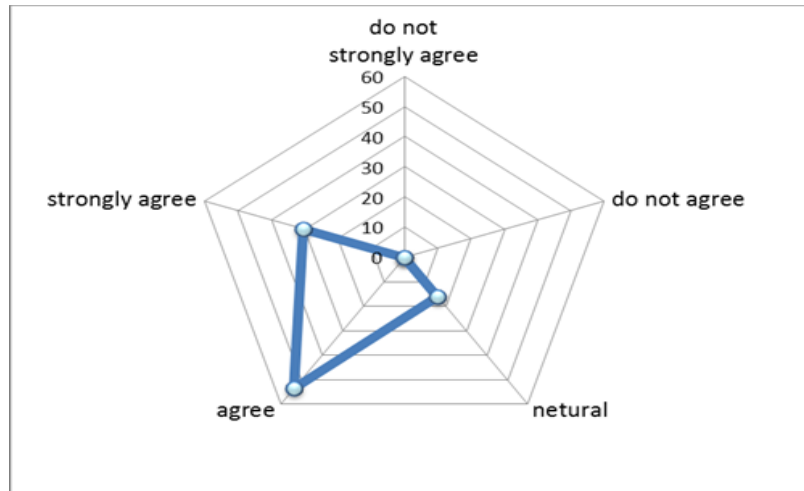


Figure 1 First Axis Frequencies Rates (External Audit Quality)

The frequencies and their rates are calculated here of the second axis items (external audit quality) as shown in Table (7) below:

Table 7 The Frequencies and their Rates of the Second Axis Items (Quality of External Audit)

Axis		Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree
External Audit Quality	frequency	0	0	286	633	153
	percentage	0	0	27	59	14

Figure (2) below shows the second axis frequencies rate as it is clear that the answers tend to agree on the items of this axis:

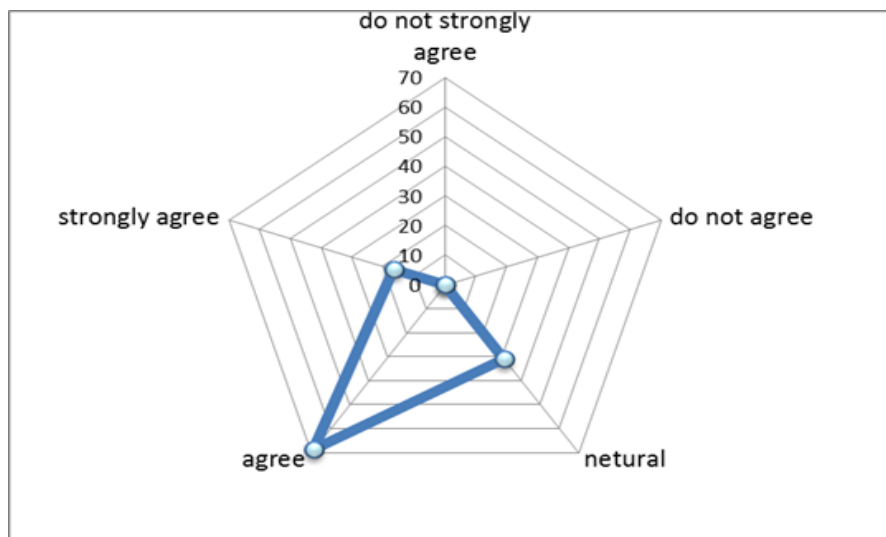


Figure 2 The First Axis Frequencies Rates (External Audit Quality)

Table (8) below shows the calculation of frequencies and their rates for all the items of the third axis (investor’s safety margin):

Table 8 The Frequencies and their Rates of the Third Axis Items (Investor’s Margin of Safety)

Axis		Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree
External Audit Quality	frequency	0	0	165	478	226
	percentage	0	0	19	55	26

Figure (3) below shows the third axis frequencies rates of the investor’s margin of safety:

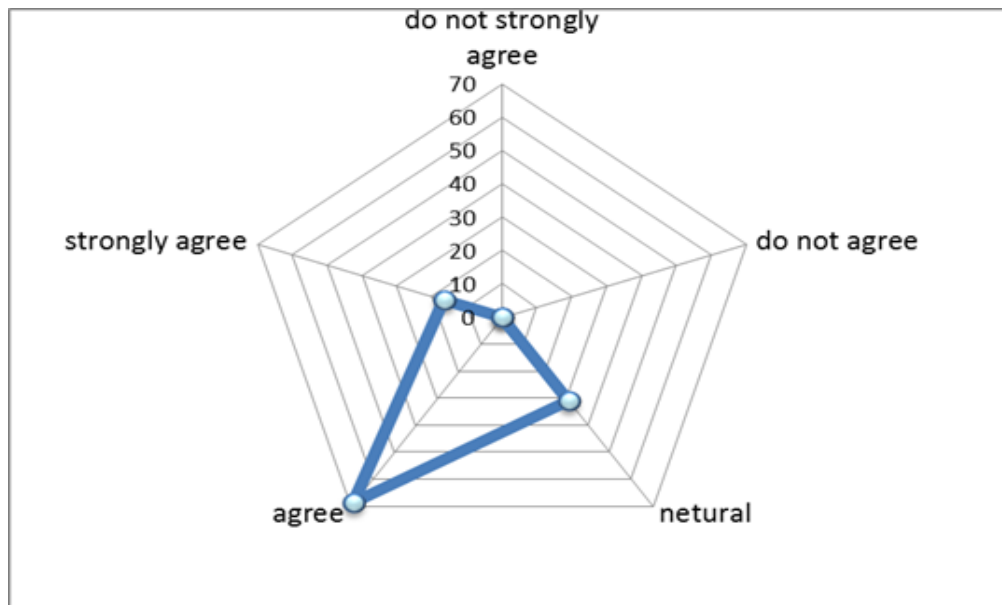


Figure 3 The Third Axis Frequencies Rates (Investor Safety Margin)

Testing the Study Correlation Values

The research has created the correlation values and their on the study three axes to verify the following null hypotheses:

- The first null hypothesis

H0: There is no correlation between quality of external audit and creative accounting methods.

- The alternative hypothesis

H1: There is a correlation between quality of external audit and creative accounting methods.

- The second null hypothesis

H0: There is no correlation between creative accounting methods and the investor’s margin of safety.

- The alternative hypothesis

H1: There is a correlation between creative accounting methods and the investor's margin of safety.

- The third null hypothesis

H0: There is no correlation between the external audit quality and the investor's margin of safety.

- The alternative hypothesis

H1: There is a correlation between external audit quality and the investor's margin of safety.

- The fourth null hypothesis

H0: The methods of creative accounting do not affect the relationship between external audit quality and investor's safety margin, if any.

- The alternative hypothesis

H1: The methods of creative accounting affect the relationship between external audit quality and investor's margin safety.

Table 9 below illustrates the correlation values and their relevance to the axes of the study:

Table 9 The Correlation Values and their Relevance to the Study Axes

Investor 's Safety Margin	Creative accounting methods	External audit quality		
.592**	-.568-**	1	Pearson Correlation	External audit quality
.000	.000		Sig. (2-tailed)	
67	67	67	N	
-.729-**	1	-.568-**	Pearson Correlation	Creative accounting methods
.000		.000	Sig. (2-tailed)	
67	67	67	N	
1	-.729-**	.592**	Pearson Correlation	Investor's Safety Margin
	.000	.000	Sig. (2-tailed)	
67	67	67	N	

** . Correlation is significant at the 0.01 level (2-tailed).

The results indicated in the above table reveal that all correlation values are significant and that the correlations are positive between external audit quality and investor's confidence margin. This means that the high quality of the external audit leads to a higher margin of investor's safety while it is the opposite between the quality of external audit and creative accounting methods. The high quality of external auditing leads to a decline in creative accounting methods, and the reversal of creative accounting methods and

investment's safety margin means that the rise of creative accounting methods leads to reduced investor safety margin, including rejection of the null hypotheses and acceptance of alternative hypotheses from which we conclude that there are positive and negative correlations with significant direct and reverse relations.

Analysis of the Effect of the Research Variables

Quality of External Audit on Creative Accounting Methods

In this part of the study, the researcher investigates the impact of the quality of the external audit on the methods of the reactive accounting from the view point of the sample of the study. Following the statistical program SPSS vr.20, the following tables confirm a coefficient of 0.32 and a corrected coefficient of 0.31. This means that the regression model reveals 32% of the total differences.

Table 10 The Impact Regression of External Audit Quality on Creative Accounting Methods

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.568 ^a	.323	.312	.32421	2.300
Model Summary ^b					

The following Table (11) represents the values of the regression modal coefficients and the significant relations:

Table 11 The Values of the Regression Modal Coefficients and the Significant Relations

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1.	(Constant)	6.509	.474		13.724	.000
	External Quality Audit	-.635-	.114	-.568-	-5.568-	.000
Coefficients ^a						

It is clear from the results above that the value of the constant of the regression model is 6.509 with the value of t test equal to 13.724 which is significant value because the value of sig = 0.000 is less than the significance level of 5%. The value of the regression coefficient was 0.635. The t-test value was 5.568, which is also significant because the value of sig = 0.000 is less than 5%. We conclude that increasing the quality of external audit by one unit leads to a decline in creative accounting methods by 64% from the point of view of the sample. Thus, the regression model can be formulated as follows:

$$y_i = B_0 + B_1x_i + e_i (1)$$

$$\hat{y}_i = 6.509 - 0.635x_i$$

$$t = 13.724, -5.568$$

The Impact of the Creative Accounting Methods on the external investment.

In this part of the study, the researcher investigates the impact of the creative accounting methods on the external investment from the view point of the sample of the study. Following the statistical program SPSS vr.20, the following tables confirm a coefficient of 0.53 and a corrected coefficient of 0.53. This means that the regression model reveals 53%. of the total differences.

Whereas, Table (12) above demonstrates the coefficients values of the regression modal of the impact of the creative accounting methods on the investor’s margin of safety.

Table 12 Regression Modal Coefficients and the Significant Relations

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	6.959	.339		20.538	.000
	Creative Accountin g Methods	-.746-	.087	-.729-	-8.581-	.000

It is clear from the results above that the value of the constant of the regression model is 6.959 with the value of t test equal to 20.538 which is significant value because the value of sig = 0.000 is less than the significance level of 5%. The value of the regression coefficient was 0.746. The t-test value was -8.581, which is also significant because the value of sig = 0.000 is less than 5%. We conclude that increasing the quality of external audit by one unit leads to a decline in creative accounting methods by 73% from the point of view of the sample. Thus, the regression model can be formulated as follows:

$$y_i = B_0 + B_1x_i + e_i (2)$$

$$\hat{y}_i = 6.959 - 0.746x_i$$

$$t = 20.538, -8.581$$

The Impact of External Audit Quality on the External Investment

In this part of the study, the researcher investigates the impact of the external audit quality on the external investment from the view point of the sample of the study. Following the

statistical program SPSS vr.20, the following tables confirm a coefficient of 0.35 and a corrected coefficient of 0.34. This means that the regression model reveals 53% of the total differences. Table (13) illustrates the sample of regression to the impact of the external audit quality on the investor’s margin of safety.

Table 13 Regression Modal to the Impact of the external Audit Quality on the Investor’s Margin of Safety

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.592 ^a	.351	.341	.32505	1.983

Whereas, Table (14) below demonstrates the coefficients values of the regression modal of the impact of the external audit quality on the investor’s margin of safety:

Table 14 Regression Modal of the Impact of the External Audit Quality on the Investor’s Margin of Safety

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	1.259	.475		2.647	.010
	External Audit Quality	.677	.114	.592	5.924	.000

It is clear from the results above that the value of the constant of the regression model is 1.259 with the value of t test equal to 2.647 which is significant value because the value of sig = 0.01 is less than the significance level of 5%. The value of the regression coefficient was 0.677. The t-test value was 5.924, which is also significant because the value of sig = 0.000 is less than 5%. We conclude that increasing the quality of external audit by one unit leads to a decline in creative accounting methods by 59% from the point of view of the sample. Thus, the regression model can be formulated as follows:

$$y_i = B_0 + B_1x_i + e_i \quad (3)$$

$$\hat{y}_i = 1.259 + 0.677x_i$$

$$t = 2.647, 5.924$$

The Indirect Impact

The indirect impact of external audit quality on the external investment was tested here through the methods of creative accounting. The Figure (4) below is the researcher’s illustration to the indirect impact of the external audit quality on the investor’s margin of safety:

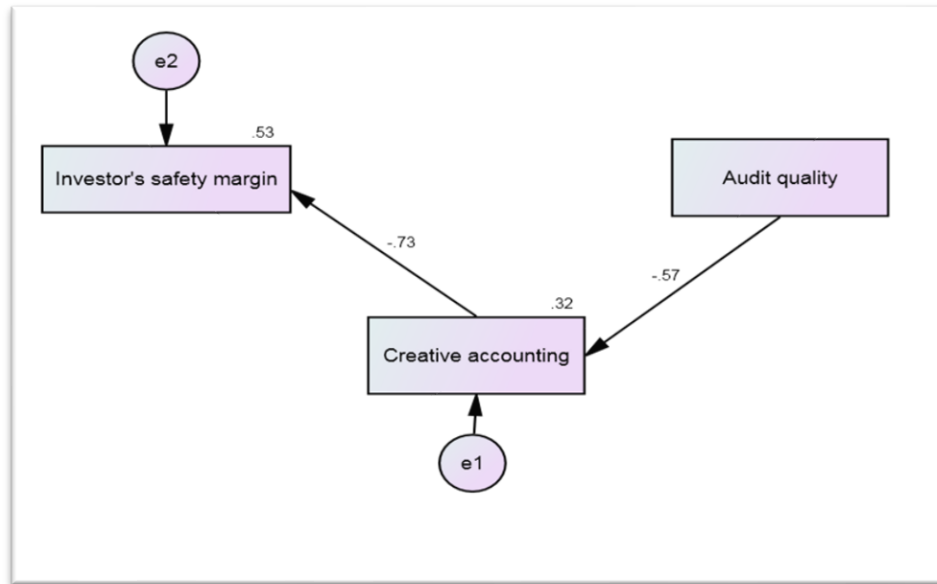


Figure 5 Indirect Impact of External Audit Quality on the Investor’s Margin of Quality

The following table shows the results obtained by the use of statistical program AMOS vr.20 which includes the direct and indirect impact of the minimum and upper limits and the significance of the impact using the method of bootstrapping, a statistical method used to demonstrate the significance of indirect impact:

Table 15 Direct and Indirect Impacts and the Upper and Lower Bounds and the Relations of the Impacts

Path	Direct effect	Lower Bounds	Upper Bounds	Sig.	Indirect effect	Lower Bounds	Lower Bounds	Upper Bounds	Sig.	Total effect	Lower Bounds	Upper Bounds	Sig.
CRA <--- AUQU	-.568	-.708	-.426	.005	.005	-	-	-	-	-.568	-.708	-.426	.005
INSA <--- CRA C	-.729	-.792	-.617	.015	.015	-	-	-	-	-.729	-.792	-.617	.015
INSA <--- AUQU	-	-	-	-	-.414	-.546	-.283	-.283	.006	-.414	-.546	-.283	.006

Through the previous analysis, it becomes clear that there is a statistical relationship between the methods of creative accounting and the margin of investor’s safety, which means that increasing the practices of creative accounting methods will reduce the margin of safety of the investor, when the preparer of the financial statements uses the methods of

creative accounting misleads the investor to know the real value of the share and thus the investor calculates a margin of safety based on a fake value, increasing the likelihood of potential risks. This affects the relationship between the quality of the external audit and the margin of safety of the investor, and it actually firstly affects the main objective of the quality of the external audit which is the discovery of errors and manipulation of financial statements, secondly affects the factors of the quality of the audit such as the impact on the independence of references in the case of a lack of some manipulation, and thirdly affects the results of the quality of the audit as a contribution to increase the gap in expectations between the auditor and the financial community, as well as impact on the margin of safety of the investor.

Conclusions and Recommendations

Conclusions

1. The methods of creative accounting affect the relationship between the quality of the external audit and the margin of safety of the investor, and this affects firstly the main objective of the quality of the external audit which is the discovery of errors and manipulation of financial statements, secondly affects the factors of the quality of the audit such as the impact on the independence of references in the case of a lack of some manipulation, and thirdly affects the results of the quality of the audit as a contribution to increase the gap in expectations between the auditor and the financial community, as well as impact on the margin of safety of the investor.
2. There is a negative aspect of creative accounting which is represented by the exploitation of flexibility and the multiplicity of accounting alternatives, especially in the field of measurement and personal assessment available in the rules and accounting norms, where it is exploited unethically to improve the image of economic unity and cover the failure to delay bankruptcy.
3. The use of the methods of creative accounting would put the investor in mind the inability of the external auditor to detect and thus affect the mutual trust between the investor and the external auditor.
4. Management aims to use creative accounting to increase income at times, and reduce it at other times, according to the objective that serves the administration, and this leads us to the conclusion that creative accounting is activities contrary to the truth, and that everything does not really express what is expressed Is a fraud designed to mislead users of information whether investors, creditors or government agencies and other related parties.

5. The absence of procedures or laws issued by the professional bodies in Iraq or the governmental organizations or the bodies responsible for monitoring the companies in the market to reduce the methods of creative accounting, which resulted in the existence of an index of high rate of profit management by companies listed in the market. The proportion of companies that practice these methods can be reflected negatively on the confidence of investors in the Iraqi Stock Exchange.
6. The study statistical analysis reveals the following:
 - A. There is a significant positive correlation between external audit quality and investor confidence margin.
 - B. There is a significant inverse correlation between the quality of external audit and creative accounting methods.
 - C. There is a significant inverse correlation between creative accounting methods and attract the external investment.
 - D. An increase in the quality of external audit by one unit leads to a decline in creative accounting methods by 64%.
 - E. Increasing creative accounting methods by one unit reduces external investment by 73%.
 - F. Increasing the external audit quality by one unit increases the external investment by 59%.

Recommendations

1. The necessity of auditing firms operating in Iraq to comply with the international standards issued by the professional organizations and associations because they have an impact on the quality of the auditing service provided by them, and this is reflected in many positive results, the most important of which is the evacuation of responsibility towards the different parties and increasing their reputation.
2. Encouraging the integration of Iraqi audit firms companies to engage with the international audit firms and in order to increase the auditing efficiency as the international audit firms are more capable of providing high quality audit services that increase the quality of financial reports.
3. Encouraging Iraqi auditing firms and companies to specialize in the client's industry. It increases the ability of the audit office to identify the problems of the industry and enables it to plan well for the audit process, which increases its ability to detect the major errors and distortions in the financial statements, and thus providing high quality services.

4. The need for the legislative and regulatory bodies in Iraq, including the Iraqi Union of Accountants and Auditors (IUAA) to determine the duration of the auditor's link with the customer, and to confirm the auditor's turnover to improve the quality of audit by maintaining the independence of auditors.
5. Utilizing the World Wide Web in the presentation and publication of audit reports of companies. There is no risk of having access to them, but it may benefit. It enables the shareholders of those companies to follow their activities on a timely basis and helps the prospective investor to obtain quick and comprehensive information before making an investment decision.
6. Focusing and working on developing and training the auditors on an ongoing basis because the practice of the audit profession requires people with special characteristics such professional awareness, culture and awareness of various economic activities and developments in the business environment and factors that may affect the credibility of the financial statements and ensures better audit services and thus improves audit quality.

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