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AUDITING FAIR VALUE ESTIMATES IN LIGHT OF THE EFFECTIVENESS OF PROFESSIONAL SKEPTICISM AND THE CHALLENGES FACING THE EXTERNAL AUDITOR. AN ANALYTICAL STUDY OF IRAQI AUDITING FIRMS STUDY OF IRAQI AUDITING OFFICES AND COMPANIES

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Abstract:

This research aims to identify the most important challenges facing auditors when measuring fair value and the importance of practicing professional skepticism for the auditor and to indicate the level of auditors' application of the requirements of auditing fair value estimates when auditing the financial statements of private commercial banks, as the auditors' practices in the Iraqi environment lack to adequate perception and guidance regarding fair value estimates in a way that enables them to exercise professional skepticism more effectively. Therefore, the discounted cash flow method was adopted in re-evaluating the investment portfolio for the shares of a number of private commercial banks in the Iraqi environment.

Keywords: fair value, challenges, professional skepticism

INTRODUCTION

The decision problems auditors encounter with complex estimations, failure to notice inconsistencies, as well as failure to collect sufficient evidence are seen as resulting from insufficient professional skepticism, so a preliminary intervention of skeptical language to induce skeptical thinking should be tested. And we assume that the language of doubt embedded in helping the auditor to judge and make a decision about auditing the activity of a company will stimulate a skeptical attitude, which is measured in terms of the auditors' beliefs and feelings (i.e. confidence and anxiety) related to the reasonableness of management's estimate of the fair value. Therefore, the study attempts to answer the following question: The degree to which auditors are familiar with accounting and auditing issues related to fair value.

Despite the improvements in the performance of the auditors, the shortcomings still indicate that the factors behind this trend may be more complex and multidimensional, and therefore we realize that there is a gap between what the auditors consider sufficient and appropriate audit evidence to support the audits of the assets and liabilities verification tools, moreover, Gaining a fuller understanding of the sources that contribute to reported deficiencies will help regulators, standard-setters, audit firms, and academics identify ways to reduce the fair value measurement gap and deficiencies reported in audits of those estimates, and the inherent subjectivity of estimating future events, along with the potentially high degree Measurement uncertainties make fair value measurements and other complex estimations challenging for auditors.

The first / reviewing the literature and previous studies

On the post-implementation challenges for measuring fair value from the perspective of external auditors, and the study (**Babajide & Oyewo; 2019**) concluded that the biggest challenge for measuring fair value is represented by the scarcity of market information about assets/liabilities and manipulation by managers of financial statements and that the size of the challenges is similar when applying fair value measurement in different One of the significant challenges in measuring fair value is the low level of awareness among financial report preparers, while the study (**Bedard & Cannon: 2017**) included an analysis of the challenges in measuring fair value related to the auditor's assessment of audit risks, and concluded that the high degree of subjectivity in

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estimating the value Fair assumptions and valuation techniques are often complex to use, and the study concluded that there is a link between uncertainties and high inherent audit risks .

The second / the challenges facing the external auditor in auditing the fair value measurement

- **concept and definition of fair value.**

Fair value defined by (**Harrison. et.al.; 2013: 9)** as "the amount at which an economic unit can sell an asset or the amount that can be paid to settle a certain obligation" and (**Whittington. et.al.; 2015 : 191**) defined it as the price that would be received upon selling an asset or will be paid to transfer a liability in an orderly transaction between market participants at the measurement date under market conditions" defined under IFRS 13 as "the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants." The history of the measurement, (**Schiller & Lundh: 2013: 26**) explained that this definition is consistent with the definition that the American accounting standards went to as an exit price

- **Requirements for the reliability of fair value measurement**:

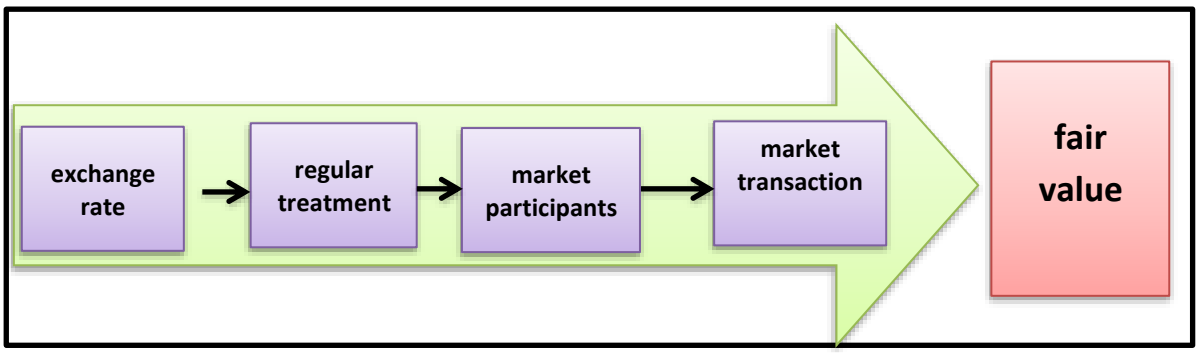
The fair value is based on four basic requirements, which are (the exchange rate, the regular transaction, the market participants, and the transaction market). The reliability of the measurement according to the fair value depends on the availability of these requirements. Fair and these requirements included the following:

1- The exchange price: specify(**FASB 157:2009: 2**)) as the price that will be received in the event of selling assets or paying off a liability, since the fair value is based on the exit price, whether the price can be observed directly or using an evaluation method and the reason is as mentioned by (**IFRS 13,2016:3**). In making the exit price necessary to measure the fair value, as it is the best indicator that represents the expectation of future cash inflows and outflows associated with assets and liabilities from the perspective of market participants at the measurement date.

2- Regular transaction: It is meant to be the transaction that is supposed to be offered to the market for a period prior to the measurement date in order to provide an opportunity for common and familiar marketing activities for transactions that include assets or liabilities whose sale and purchase are conditional on being a regular transaction and not a liquidation, coercive or bankruptcy transaction.

3- Market participants: They are the buyers and sellers in the market, who are independent of each other and have a reasonable knowledge and understanding of the assets and obligations using all available information, including information that requires various efforts to obtain.

4- Transaction Market: The fair value measurement assumes that the transaction for the sale of the asset or the settlement of the liability takes place in the main market, and reliance is placed on the most appropriate market for the assets or liabilities in the absence of the main market (**Allal and Al-Khader : 2019: 252**), and Figure No. (1 These four requirements are summarized as follows



Source // Prepared by the researcher
Figure No. (1) Requirements for the reliability of fair value measurement

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There are some concerns worldwide related to the application of fair value in developing countries, including the Iraqi environment. These concerns have been clarified by rhesearchers, as follows (**Pacter ;2014:25**) **(Glover & Taylor, 2016: 115):**

1- Inactive markets: Transactions are rare in developing countries and are affected by market prices where markets are inactive and these markets do not provide reliable indicators for measuring fair value.

2- Cost: The cost of applying the principles of recognition and measurement is higher than the benefits accruing to the units, especially in the absence of active financial markets, which causes an increase in the cost and time required to audit and review fair value measurements.

3- Lack of skill: A number of developing countries face a shortage of skilled property valuers, actuaries, and other specialized valuers, and therefore financial reporting units face a difficult situation because they do not have the necessary skill to estimate fair value.

4- Related parties to the transaction: A relatively high percentage of transactions are entered into with related parties in some developing countries, and as such, transactions may not reflect the length of the market arms.

5- Government control over markets: Market prices may be affected by government control or interventions in market prices and therefore do not reflect normal market interactions.

6- Weak regulatory environment: Due to the lack of application of international financial reporting standards (IFRS) as it should be in developing countries, being complex and costly for them, this led to weak regulation and the difficulty of relying on these markets.

7- The absence of application standards and guidance: that is, the absence of additional guidance for the application of fair value in developing countries in accordance with international financial reporting standards.

- **Challenges in auditing fair value estimates:**

The auditor faces many challenges when auditing fair value estimates, including (**Martinez. et. Al; 2006: 696)** that the basis of the estimate depends on constantly changing prices in active markets, or equivalents and similar prices in inactive markets, or based on estimates based on complex models and their reliance on assumptions. Affected by the personality and experience of the evaluator and the attitudes of management in many cases. The auditor (**Johnson: 2007 : 17**) lacks appropriate technical knowledge about measuring fairness, which necessitates the auditor to acquire these skills, including determining the level of evaluation models and the reasonableness of the assumptions associated with evaluation, as explained (**Pannese & Delfavero: 2011 :43**) the challenges of collecting evidence related to the reasonableness of the assumptions of fair value estimates and the appropriateness of measurement models in light of the prevailing circumstances when preparing the financial statements, which requires the collection of sufficient and appropriate evidence.(**Palea & Maino :2013:5**) The general structure of the audit without providing detailed procedures of sufficient evidence for the auditor to enhance his technical opinion and help him provide reasonable assurance about the fairness of the financial statements, as explained (**VRC: 2013 : 2**) Verifying the fairness of disclosure about the methods and assumptions adopted to determine the fair value of assets and liabilities and the estimation mechanism, whether in the active market or on the basis of mathematical models in the case of inactive markets.

The third; the effectiveness of professional skepticism in auditing fair value estimates:

The decision problems faced by the external auditor with complex estimates of fair value, including over-reliance on management assumptions and failure to notice inconsistencies and gather sufficient evidence, are generally seen to result from insufficient professional skepticism (**PCAOB, 2012:15**), and there is a new trend To improve complex fair value estimation audits and add to the growing evidence that improved critical thinking is key to improving audit quality (**Kohlbeck:2017:27**), the auditor understands the importance of evidence in improving the quality of audits of fair value estimations, and therefore auditors are expected to be experienced and knowledgeable. **(Doliya& Singh:2016:302-316**) Those ablest to benefit from that evidence and changing how auditors use the evidence they possess, rather than simply urging them to obtain more evidence, is a promising path to improving the audit quality of fair value estimates, as failure to properly examine audit evidence can lead to issuance Inaccurate judgments, such as the decision to end the evidence collection work before its completion, which is caused by not exercising sufficient professional skepticism (**Appah & Ogiriki: 2018: 20**).

The fourth / testing hypotheses

The research is based on the following hypotheses:

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1- There is no correlation between the two research axes, "the challenges facing the external auditor in auditing fair value estimates," and "the effectiveness of professional skepticism."
2- There is no correlation with a significant impact between the first main axis, "challenges facing the external auditor in auditing fair value estimates," and the second main axis, "the effectiveness of professional skepticism."
The research community included auditing companies and offices of (255) companies and offices, according to the auditors' bulletin, in all governorates of Iraq except for the Kurdistan region. Responsible for auditing all Iraqi companies and banks in the private sector.

Procedures for auditing the fair value of investments in long-term shares:

A. measuring the fair value in banks.

The statement of financial position and additional clarifications showed that the management of the (Baghdad Commercial Bank) measured part of its shares on the basis of the prices listed in the financial market, and the other part included the evaluation of shares on the basis of cost, and thus the occurrence of a state of mismatch in the accounting measurement, which affects the quality of the accounting information that it contains. The financial statements of the bank as well as the reports of the auditors, as Table No. (3) shows the percentage of mismatch in the accounting measurement in the investments of the Bank of Baghdad, and the management was not alerted and focused on by the auditor when expressing an opinion, starting from the fiscal year 2017 until 2021. Reaching the percentage of mismatch in the accounting measurement in the Commercial Bank of Baghdad through the following equation:

The value of shares that do not have an active market ÷ The total value of investments in stocks = the mismatch ratio in the accounting measurement.

Table No. (1) Accounting measurement mismatch ratio

year	The degree of mismatch in accounting measurement
2016	84% =5,471,753 ÷ 4,634,506
2017	82% =4,666,318 ÷ 3,839,084
2018	85% 4,182,827= ÷ 3,568,869
2019	85 % = 4,738,042 ÷ 4,070,810
2020	45 % = 2,368,857 ÷ 1,078,998
2021	84% = 5,471,753 ÷ 4,634,506

Source / authorization of the researcher based on the data of the Commercial Bank of Baghdad from the year 2017-2021

Through Table No. (1), the percentage of the measurement of the stock investments of the Bank of Baghdad on the basis of cost ranged from (82% to 85%), except for the year 2021, when the percentage of the measurement on the basis of cost was one penny. percentage (45%), as these indicators are considered not good and they say that the calculations include the objective measurement of financial investments at fair value Each part was evaluated on the basis of fair value prices listed in the active financial markets, and the other part included an evaluation Investments are valued on the basis of cost and not on the basis of a fair value valuation model.

B. The opinion of the external auditor on the fair valu estimates of stock investments in banks

, by reviewing the reports of the external auditor on the final statements of the banks mentioned in Table No. (1) and studying the reports of the Board of Directors We present a summary of the auditors' opinion on the fair value of the shares held for the purpose of collection by those banks, and a statement of the methods used by those auditors in question in examining the validity of those accounting estimates after their approval. on the financial statements for the period from (2016 to 2021), as shown in Table No. (2) below

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Table No. (2) The external auditor's opinion on the fair value of long-term equity investments

1/ The name of the bank: / Baghdad Commercial Bank
The opinion of the external auditor: - The fair value of the financial assets was evaluated based on To the prices of the last session held for the Iraqi market for securities. - No financial confirmations were obtained. Statement of the Bank's investments in corporate shares (as of (31/31) 12/2018, (which the cost of purchasing it amounted to (852.340) thousand dinars in companies (Rafidian grain, generators industry, tourist Sindbad, food industries, construction materials), as well as We did not obtain confirmations of the validity of the investments in shares, whose purchase cost amounted to (847.964) thousand dinars on 12/31/2020 and an amount of (82.161) thousand dinars on 12/31/2021 in the aforementioned companies. - the consolidated financial statements clearly and fairly show the essential aspects of the consolidated financial position D to the bank as of 31/12/2021 .
2/ Commercial Sumer Bank
Opinion of the external auditor: The audit was conducted in accordance with international and local auditing standards, and the financial statements are free from significant or significant misstatements, whether resulting from fraud or any fundamental error.
3/ Mosul Bank for Development and Investment
The opinion of the external auditor: - Investments in limited companies have been recorded at cost because there is no fair value that can be reached to evaluate the shares. - The bank did not evaluate the investments based on the price of the last session of the Securities Commission . - The consolidated financial statements show clearly and fairly the essential aspects of the consolidated financial position of the bank as well. 12/31/2021 .

Source / prepared by the researcher based on the auditors' reports.

It is clear in Table No. (2) that the researcher did not infer a number of axes that there is no indication that the auditor has reviewed and presented them in the audit reports of all the mentioned banks, as they reflect the level of the auditor's awareness of fair values auditing. These were represented by the following observations:

1- It has not been confirmed that the management has taken into account the fluctuations in market prices, the level of risks associated with the market, and the analysis of changes and fluctuations in evaluating the fair value of investing financial assets, in a manner through which the auditor can exercise professional doubt about the appropriate evidence for that accounting estimate.
2- It has not been confirmed that the important accounting information disclosed was appropriate and characterized by a great deal of reliability and an indication of the extent of its reflection on measurement and presentation within the applicable financial reporting framework, on account balances and related disclosures.
3- The nature and type of appropriate evidence through which the auditor can ascertain the reasonableness and correctness of the methods used by the management in the evaluation has not been clarified, as the importance of audit evidence is reflected in the auditor's professional skepticism, which primarily reinforces the reasonableness and realism of what the administration went to when developing and choosing it. for its assumptions and interpretations.

C. Analyzing the variables of fair value estimates for long-term equity investments.

The fair value evaluation of the banks' equity investments is reviewed as a model that can be used by the external auditor in examining and evaluating the management's disclosures about the fair value through the following calculation steps:

1- The return rate per share and the market RE / RM

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The return per share shows the percentage of profit achieved for each ordinary share during the fiscal period. The return per share and the market return are calculated for banks whose activities are subject to audit The auditors are the research sample, where the rate of return on the stock and the market will be calculated for the month (December / 2021) as growth A calculation model is based on the monthly rate and for the period of the year (2016-2021) according to the following equations:

$$\textbf{Rs} = \frac{Po - Pi + Dij}{Pi}$$

Rs = stock return.
Po = Opening price Monthly per share.
Pi = The monthly closing price of the stock.
D =Dividend per share.

Calculation of the market and share return for the Commercial Bank of Baghdad for the year / 2021

Earnings per share for the month (D/2021)= $\frac{1.3-0.41+0}{0.41}$ **=** 2.17073 **dinar**

As for the rate of return on the market, the return on the investment portfolio, which consists of all the shares of the economic units listed in the Iraq Stock Exchange, is calculated through a sample consisting of (43) A commercial bank listed in the Iraq Stock Exchange according to the following equation:

$$\textbf{Rm} = \frac{Ii - I}{I}$$

RM=Return of the market portfolio.
Ii= Subsequent observation of the market index.
I= Previous observation of the market index

Market return for the month (D/2021)= $\frac{567.472-461.701}{461.701}$ **= 0.22908 dinar**

Tables No. (4, 5, and 6) below show the calculation of stock and market returns for the Baghdad Commercial Bank, noting that the above-mentioned equations have been applied to the rest of the banks, and below are the results of applying the equations to the prices of Baghdad Commercial shares, as follows

Table No. (3) (opening and closing prices, the amount of return per share, and the market for the (Baghdad Commercial) Bank of Baghdad

Baghdad Commercial Bank					
Year	opening price	Closing Price	cash dividends	stock return	market return
2016	1.13	0.91	0	-0.19469	97.75
2017	0.9	0	0.6	-0.33333	44.8
2018	0.61	0.29	0	-0.52459	-0.01011
2019	0.3	0.3	6.21	20.7	-0.00399
2020	0.31	0.41	0	0.322581	-0.00177
2021	0.41	1.3	0	2.170732	0.00896

Source / prepared by the researcher based on the bank's published data.

It is clear that the Bank of Baghdad achieved the highest opening price during the year 2016 by (1.13) dinars, and it achieved the lowest opening price during the year 2019 by (0.3) dinars, while it was the highest The closing price in the year (2016) was (0.91) dinars, and the lowest closing price in the year (2019) was (0.3) dinars

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Table No. (4) The opening and closing prices, the amount of return per share, and the market for the (Sumer Commercial) Bank

Sumer Commercial Bank					
Year	opening price	Closing Price	cash dividends	stock return	market return
2016	0.95	0.9	3.64	3.778947	97.75
2017	0.9	0.9	3.76	4.177778	44.8
2018	0.9	0.9	0	0	-0.01011
2019	0.9	0.51	1.4	1.122222	-0.00399
2020	0.51	0.4	0	-0.21569	-0.00177
2021	0.4	0.38	0	-0.05	0.008961

Source / prepared by the researcher based on the bank's published data.

Through Table No. (4), the Sumer Commercial Bank obtained the highest ranking The opening price during the year 2016 amounted to (0.95) dinars, and it also achieved the lowest opening price during the year 2021 by (0.4) dinars, while it was the highest closing price in the year

Table No. (5) Opening and Closing Prices, Earnings per Share and Market for (Mosul Development and Investment) Bank

Mosul Bank for Development and Investment					
Year	opening price	Closing Price	cash dividends	stock return	market return
2016	0.25	0.56	**0**	1.24	97.75
2017	0.55	0.32	**0**	-0.41818	44.8
2018	0.32	0.16	**0**	-0.5	-0.01011
2019	0.17	0.16	**0**	-0.05882	-0.00399
2020	0.16	0.13	**0**	-0.1875	-0.00177
2021	0.14	0.15	**0**	0.071429	0.008961

Source / prepared by the researcher based on the bank's published data.

Through Table No. (5), Mosul Bank obtained the highest opening price during the year 2016 by (0.55) dinars. It also achieved the lowest opening price during the year 2021 by (0.14) dinars, while the highest closing price was in the year (2016) by (0.56). Dinars, and the lowest closing price in the year (2020) was (0.13) dinars.

2- The beta coefficient (β) of a stock The risk of stocks varies according to the value of the beta coefficient. For example, if there are certain stocks that have a coefficient of beta, then This means that the changes in the return of the share are equal to the change in the return of the market in addition to greater than one (β>1) so the risk of these shares is high. Da, and it is called Stock Aggressive, (if the beta coefficient of the share is less than one integer (1) <β (it will be less risky than the return of the market portfolio if the beta coefficient is equal to one (β = 1) They are called conservative or defensive stocks (Rm), which means that the risk of stock returns is equal to the risk of returns of the market portfolio (Rm, by calculating the value of The beta coefficient is according to the following mathematical equation:

$$\beta = \frac{\mathbf{Cov(Ri\ Rm)}}{\boldsymbol{vRM}}$$

β= Beta
(Cov / Rm Ri)= The common discrepancy between the stock return and the market return
VRm = Market portfolio return variance

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The beta coefficient of the stock can be calculated through the following equation:

$$\text{stock beta} = \frac{\text{The standard deviation of the return on the stock} * \text{The value of the correlation between earnings per share and the market}}{\text{The standard deviation of the market}}$$

$$\beta = \frac{7.659728}{126.8714} * -0.33011 = -0.0200 \text{ Baghdad Commercial Bank share beta}$$

After using the same steps whose results are presented in Tables (3, 4, 5) and applying Equation for calculating (share beta) The results of calculating the share beta for banks (Baghdad) are included Al-Tijari, Sumer Al-Tijari, Mosul, Development and Investment) and through the mathematical equations that the researcher used after calculating the value of the return on the stock and the return on the portfolio The market for the economic unit and for the same period, as shown in Table No. (6) below

Table (6) the results of the data of the economic units of the research sample to reach the beta of the stock risks

Bank name	Average earnings per share, R/E	average market return , R/M	ce	Market return variance	Correlation between market return and share return	for the standard deviation of the stock	The standard deviation of the market return	β
Baghdad	3.690116	0.1493369	70.40572	16096.36	-0.33011	7.659728	126.8714	- 0.0200
Sumer	1.468877	0.1493369	4.019416	16096.36	0.856482	1.830168	126.8714	0.012355
Mosul	0.024487	0.1493369	0.400519	16096.36	0.773638	0.632866	126.8714	3.859098

The source was prepared by the researcher / using mathematical equations and applied programs.

According to Table No. (3), the first and second columns represent the average return of the stock and the market, which was extracted through the sum of the values according to their numbers and using the (Average) function, which is considered One of the functions of the Excel program, while the third and fourth columns represent the variance of the stock return and the market return of the economic units in question using the (VAR) function, either the coefficient The correlation between the return on the share and the market return of the economic units was calculated by using the (CORREL) function, as well. The fields for calculating the standard deviation value of the return of the stock and the market were the result of using the STDEVA function (for each of the returns d the stock and the market, and as a result of applying the beta law by dividing the standard deviation value of the stock by the standard deviation value of the market multiplied by the value of the correlation between the return of the stock and the stock Then, a coefficient (beta) is reached.

Where the expected interpretation of the results of the coefficient (β) can be interpreted as follows:

$\beta < 0$ inverse correlation between stock returns and market returns.

$\beta = 0$ there is no correlation between stock returns and market returns.

$1 < \beta < 0$ positive correlation and the change in stock returns is less than the change In market returns.

$\beta = 1$, the correlation is positive, as stock returns change with the same change in market returns

$\beta > 1$, positive correlation, and the change in stock returns is greater than the change in market returns.

3- The risk-free average rate

The risk-free rate is (5.32) for the year 2021 according to the statistical bulletins Which are issued by the Central Bank of Iraq and issued by the General Directorate of Statistics and Research, as shown in Table (7) below:

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Table No. (7) The risk-free rate for the research sample years

year	% risk free rate
2016	4.96
2017	5.73
2018	5.51
2019	5.34
2020	5.55
2021	5.32

Source: Statistical releases issued by the General Directorate of Statistics and Research at the Central Bank of Iraq.

Where the risk-free rate was calculated for the year 2021 and previous years according to the following equation:

$$\text{risk free rate} = \frac{\text{Total interest rates for low risk investments}}{\text{sum of values}}$$

$$\text{risk free rate} = \frac{63.93}{12} = 5.32\ \%$$

4- Equity financing cost

The equity financing cost model consists of three main variables: the risk-free rate Rf, the market rate of return Rm, and the beta coefficient of the economic unit stock. β, and through these three variables, the parameters of the capital asset pricing model (CAPM) are calculated (by finding the relationship A relationship between the risk-free rate for the year 2021, the average earnings per share and the beta coefficient was reached. The required rate of return according to the following equation: R=Rf+(Rm-Rf)β

R= required rate of return

R f = risk free rate
R m = market return

Calculating the risk-free rate for the Baghdad Bank

$$R = Rf + (Rm - Rf)\,\beta$$

$$R = 0.0532 + (0.1493369 - 0.0532) * -0.0200 = 0.05127 \text{ required rate of return}$$

By applying the same equation to the remaining banks, we arrive at the rates listed in Table No. (5) below**:**

Table (8) Parameters of the Capital Assets Pricing Model (CAPM)

Bank name	risk free rate %	average market return	β beta stock	% required rate of return
Baghdad	0.0532	0.1493369	- 0.0200	0.05561
Sumer	0.0532	0.1493369	0.012355	0.05369
Mosul	0.0532	0.1493369	3.859098	0.06052

Source: Prepared by the researcher based on the published financial statements of the banks.

Through table (8), we find that the value of the required rate of return using the capital asset pricing model equation, through which we can reach the cost of equity financing, noting that Mosul Bank for Development and Investment has achieved the highest required return, while the total equity of banks has been included in Table No. (9) below:

Table (9) Total equity of commercial banks - amounts in millions

Bank name	paid Capital	Total equity
Baghdad	250,000,000,000	309.129.878
Sumer	250,000,000,000	263.997.158
Mosul	252,500,000,000	271.494.336

Source: Prepared by the researcher based on the published financial statements of the banks.

Table (9) shows the balances shown in the list of financial position of banks. It is clear that the value of equity represents the financial structure of those banks, while the value of debt financing was zero, which is an indicator

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This indicates the reliance of these banks on property rights for internal financing, and there is no external long-term financing because of the banking policy pursued by the management of these banks in To finance its activity, a weighted average was reached based on the cost of capital on the basis of the cost of equity. Table No. (10) shows as below:

Table (10) weighted average cost of capital

Bank name	cost of equity	Debt cost	β beta stock
Baghdad	**0.05127**	0	**0.05127**
Sumer	**0.05440**	0	**0.05440**
Mosul	**0.42420**	0	**0.42420**

Source: Prepared by the researcher based on the published financial statements of the banks.

5- Free Cash Flow (FCF)

In order to ensure the correctness of the banks' estimates of financial assets, the following must be calculated: Free cash flow = net operating cash flow - Investment spending - Cash dividends. Operating cash flow = earnings before interest and taxes + depreciation - taxes + - change in working capital. Change in working capital = net working capital for the current year - net working capital for the previous year.

The method of calculating the free cash flow of the Bank Baghdad for the year 2021.

The money worker is a capital in change =271.592.111 - 240.244.160 = 31.347.95
Dinars
For my cash operation = 37.148.363 + 1.801.673 - 7.168.179 + 31.347.951 =
63.129.987 Dinars
Free Cash Flow = 63.129.987 - 8.050.031 - 0 = 55.0979.956 Dinars

In light of that calculation, the free cash flows for the previous years and for the remaining banks are reached according to the results presented in Tables 8-9 (cash flow). Free credit to banks whose activities have been audited by the auditors in question, for the period from (2016 to 2021).

Table (11) Free cash flow of the Bank Baghdad - amounts in thousands of dinars.

Date	2016	2017	2018	2019	2020
Net wind (loss) after tax	**20.450.029**	**6.122.480**	**4.152.102**	**7.298.604**	**20.200.071**
depreciation	**2.429.740**	**1.913.664**	**1.946.938**	**1.654.482**	**1.948.886**
The change in working capital	**-224.381.026**	**58.248.183**	**-6.298.067**	**-121.664..839**	**125.325.635**
net operating flow	**-201.706.257**	**66.284.327**	**-199.027**	**-112.711.743**	**147.474.592**
capital spending cash	**0**	**4.134.344**	**3.609.094**	**14.743.371**	**7.673.204**
Distribution of dividends	**0**	**17.500.000**	**0**	**155.255**	**0**
Free cash flow	**-201.706.257**	**44.649.983**	**-3.808.121**	**-127.446.114**	**139.801.388**

Source: Prepared by the researcher based on the published financial statements of the banks

Through Table No. (11) and looking at the income statement, it is clear that the Commercial Bank of Baghdad achieved the highest net profit after tax during the year 2021, at an amount of (29,980,363) thousand dinars, then followed by the years 2016, 2020, 2019, 2017, 2018, respectively, as The bank achieved the highest net operating cash flow in the year 2020 with a value of (147,474,592) thousand dinars, as a result of the increase in the value of the change in the working capital. Table (12) shows the bank's distribution of cash profits during the two years (2017, 2019). As for the free cash flow, the bank achieved the highest free cash flow during the year 2021 with a value of (139,801,388) thousand dinars, and it is considered the best year for the bank among the years under consideration, while it was achieved for the bank in the year 2018 with a value of (-127,446,114), which is the lowest operating cash flow level.

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And based on the steps contained in Table No. (12), the results for the banks (Baghdad Commercial, Sumer Commercial, Mosul for Development and Investment) were reached according to Table (12) below:

Table (12) Free cash flow for commercial banks - amounts in thousands of dinars

Bank name	2016	2017	2018	2019	2020	2021
						Free cash flow
Baghdad	201.706.25-7	44.649.983	-3.808.121	-127.446.114	139.801.388	55.079.956
Sumer	11.777.923	14.127.752	-2.615.743	-1.894.198	-3.657.455	33.167.413
Mosul	356.563.691	479.882.380	381.441.650	395.391.267	104.786.349	179.018.782

Source: Prepared by the researcher based on the published financial statements of the banks

Through the results of Table No. (12) and the balances shown in the income statement, it is clear that the Mosul Bank for Development and Investment achieved the highest net profit after tax during the year 2017, at an amount of (4,895,038,845) million dinars, then followed by the years 2016, 2021, 2019, 2018, 2020 on respectively, the bank also achieved the highest net operating cash flow in 2017 with a value of (5,851,401,314) million dinars, while the free cash flow, Mosul Bank achieved the highest free cash flow during the year 2017 with a value of (479,882,380) thousand dinars.

6- Terminal Value

The final value of the economic unit is calculated according to the following equation:
Present value of free cash flows + present value of terminal value - debt
The final value can be calculated using the Perpetuity Growth Model

Perpetuity Growth Model

This method is based on the Gordon Growth model, which is based on the assumption of the state of continuous growth of the economic unit and the same growth rates that were assumed to reach the free cash flow. The Perpetuity Growth Model includes the following equation:

$$TV=\frac{FCF*(1+G)}{WACC-G}$$

TV =Terminal Value
FCF = The average free cash flow for the years of the research sample
G =Permanent annual growth rate of cash flows
WACC = Weighted average cost of capital
(The researcher does not assume a growth rate on the basis that the generation of free cash flows continues at one level).

Calculating the final value of the Al Ahly Bank of Iraq

$$\mathbf{TV = \frac{95415303*(1+0)}{0.05127-0} = 1.861.035.752 \text{ dinars}}$$

Based on the method of calculating the final value of the Baghdad Commercial Bank, the final value (TV) was reached for the banks (Sumer Commercial, Mosul for Development and Investment) as shown in Table No. (13) :

Table (13) final value of commercial banks - amounts in thousands of dinars

Bank name	*final value*
Baghdad	1.861.035.752
Sumer	206.006.379
Mosul	7.453.575.837

Source: Prepared by the researcher based on the published financial statements of the banks.

7- Present value of free cash flow and terminal value

The net present value of free cash flows and the final value are calculated according to the following formulas: -
- Net present value = free cash flow * discount factor for irregular cash flows for each year.
- discount cash flows = $1\div(1+R)^n$.

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R = The interest rate is (weighted average cost of capital) .
N = Number of years .

Calculating the net present value of free cash flows and deducting the final value of the Baghdad of for the year 2021-2021.

Free cash flow discount**=** $1\div(1+0.05127)^{6}$= = 0.7408 Dinars
The net present value of free cash flows = 55.079.956 * 0.7408 = 40.804.490 Dinars
The net present value of the final value =1.861.035.752*0.7408 =1.378.655.285 Dinars

Based on the above equations, the results related to deducting the free cash flows and the final value of the banks were reached according to what is shown in Table (11).

Table (11) Net Present Value of Free Cash Flows and Final Discounted Value - Amounts in Thousands of Dinars

Bank name	2016	2017	2018	2019	2020	2021	final discounted value
Baghdad	**-191.869.127**	**40.401.060**	**-3.273.671**	**-104.344.488**	**108.877.998**	**40.804.490**	**1.378.655.285**
Sumer	**11.170.261**	**12.707.563**	**-2.231.407**	**-1.532.511**	**-2.806.416**	**24.136.774**	**11.206.747**
Mosul	**356.563.691**	**441.620.610**	**381.441.650**	**334.854.494**	**85.131.646**	**139.521.837**	**5.809.092.117**

Source: Prepared by the researcher based on the published financial statements of the banks.

Table (11) shows the current value of the free cash flows and the final discounted value, as they are the main elements in calculating the total value of the economic unit, noting that the discount coefficient for the final value represents the discount coefficient for the irregular cash flows for the last year (the sixth year / 2021).

D- Estimating the fair value of net assets

The fair value of the commercial banks that have been audited by the external auditor is estimated by calculating the following:
The value of the economic unit = the total discounted cash flows + the final discounted value
Net assets (property equity) = value of the economic unit - outstanding debts
And in application of the calculation methods referred to above, the net assets of commercial banks were reached, as shown in Table (12) below.

Table (12) Fair value of net assets of commercial banks - (amounts - in thousands)

Bank name	Total discounted free cash flow (1)	Discounted Final Value (2)	Economic unit value 1 + 2 = 3	outstanding debts (4)	Net assets (equity) 3-4=5
Baghdad	**-109.403.738**	**1.378.655.285**	**1.269.251.547**	**42.306.043**	**1.226.945.504**
Sumer	**41.444.264**	**11.206.747**	**52.651.011**	**46.633.516**	**6.017.495**
Mosul	**1.739.133.928**	**5.809.092.117**	**7.548.226.045**	**3.095.967.139**	**4.452.258.906**

It is noted from table (12) that the Mosul Bank for Development and Investment obtained the highest discounted free cash flows, and the highest discounted final value, after subtracting the outstanding debts. Which was subtracted from the total value of the economic unit, and the fair value of the banks' shares was reached.
According to (according to the following method: Table 13.)

(net assets) / (paid-up capital) number of shares) = output * asset ratio to total assets = estimated value of repair.

Table (13) estimated fair value of shares

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Bank name	Estimated fair value of the share
Baghdad	$\frac{1.226.945.504}{250.000.000.00}$ **= 4.90 * 0.153 = 0.0484 dinars**
Sumer	$\frac{6.017.495}{250.000.000.00}$ **= 2.40 * 0.830 = 1.992 dinars**
Mosul	$\frac{4.452.258.906}{252.500.000.000}$ **= 1.7632 * 0.611= 0.88 dinars**

When comparing the market value of bank shares for the fiscal year ending on (31/12/2021) with the estimated fair value that was reached, we include the following observations:

Table No. (14) Comparison between the market value approved by banks and the estimated fair value

Bank name	Estimated fair value of the share	The market value of the share	Notes
Baghdad	**0.88 dinars**	**3.1 dinars**	- The bank's shares are trading at a price higher than its fair value, with a difference of (42.0) dinars. - The complexities associated with calculating the fair value estimates require the auditor to understand the rationale in light of which Calculating that estimate in a way that improves his professional doubts about the audit evidence.
Sumer	**1.992 dinars**	**0.38 dinars**	- The bank's shares are trading at a price higher than its fair value, by a difference of (1.612) dinars. - The occurrence of a difference between the accounting estimate and the value of the amount disclosed in the statement of financial position does not necessarily mean that there is an error in the financial statements. Because the price adopted for measurement was on the date of preparing the financial statements, given that the results that are observed are often affected by events after the date of measurement, which is It was confirmed by the International Standard on Auditing (540), so the auditor's goal of re-testing The accounting standard is for the purpose of obtaining a reasonable indication of the results reached, whether they are similar or different. Significantly .
Mosul	**1.077 dinars**	**0.15 dinars**	- The bank's shares are trading at a price lower than its fair value, with a difference of (0.927 dinars). - The effect of the evaluation differences between the market value and the fair value is reflected in the quality of disclosure of the presented accounting information In the

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			financial statements, this effect is evident through the contradiction between what was adopted by the management, which represented the cost price per share and disclosed in the statement of financial position, and the estimated fair value that the researcher reached.

E- hypotheses testing After testing the research hypotheses using the analytical method, it was found that there is a positive relationship with a correlation and impact between the two axes of the research 'Challenges facing the external auditor at Check fair value estimates and show the effectiveness of professional skepticism

F- CONCLUSIONS:

Through the previous presentation, the researcher reached a set of conclusions that can be formulated as follows:

1- The results of the practical analysis proved that the external auditor lacks sufficient experience and skill to audit the fair value estimates in Under the multiplicity of methods of measurement and dependence on personal judgment.
2- The results of the practical analysis proved that it is difficult for the external auditor to obtain reliable accounting information related to fair value estimates, which leads to the possibility of adopting inappropriate audit evidence and limits the effectiveness of the professional skepticism of the auditor. external.
3- The results of the empirical analysis demonstrated the lack of detailed guidance on procedures for auditing fair value estimates and the nature of sufficient and appropriate audit evidence that is used. It increases the auditor's skepticism and addresses any gap in checking those estimates.
4- The results of the practical analysis proved that there are challenges related to the fair value basis as a result of the lack of active markets for measuring some assets, and that the auditors often need an expert or specialized valuation experts.
5- The results of the practical analysis proved that the main problem is the reliance of some economic units on a mixed measurement model to measure some financial assets at fair value, while the Measurement of some other assets at cost, which leads to accounting inconsistency in measurement and contradicts the principle of trust.
6- The external auditor should enhance his awareness of the requirements of fair value estimates and an understanding of the activity of the economic unit in order to be able to practice auditing with high efficiency. It is reflected in the quality of the reports submitted by those auditors.
7- The external auditor should obtain a sufficient understanding of the foundations upon which the management of the unit was based. The most important of which is the evaluation of stock investments that do not have a main and active market.
8- The importance of the external auditor to recalculate the fair values The range of inputs approved by the banks management in evaluating stocks and technical knowledge Evaluation methods.
9- The external auditor should identify and assess the risks of material misstatement that may be involved in the fair value estimates.
10- The importance of the external auditor choosing appropriate evidence related to the fair value estimates, which enhances the effectiveness of his professional skepticism and the provision of a neutral technical opinion.

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