# What Exactly Financial Auditors Report Give the Divergence Between Ethics, Social Responsibility and Financial Performance. Is the Audit Profession Still Sustainable?

**Florin DOBRE** [1]
**Adriana Florina POPA**
**Ada Lorena NICULIȚĂ**

*Abstract*

*With the installment of the economic crisis, there have been numerous question marks related to the level of credibility of reports delivered by the financial auditors. As to counter the effects of the economic crisis, there have been taken measures to stabilize the financial system, where an important role is being attributed to banks, rating agencies, surveillance entities or national banks. The audit's function needs to be consolidated in order to regain the reputation it had previously the crisis. Financial audit should contribute in a substantial manner to the financial stability of the state. At present, the audit report represents a guarantee for the credibility of financial statements. The reasonability or validity attributed to the financial statements of companies going through difficult situations can, still, mislead investors' and public's opinions. We consider that a better defined role of the financial audit could become useful in truly fulfilling its social functions expected by the public.*

**Keywords:** *consolidation of financial statements, audit reporting, financial performance, corporate social responsibility.*

**JEL classification: G01, M42, M48.**

## Introduction

The problems regarding the financial audit report are due to the recent economic scandals, to the changes of macroeconomic environment and to the credibility that people confer to them. Moreover, the questions about the quality of audit are frequently met as the auditors should provide a minimum level of assurance about the performance that a company had obtained during a financial year. The explication lies in the fact the financial audit report is quite short, offering less information for public than for the shareholders, but still it does not cover the description and analysis of all financial indicators, revenues or charges

[1] **Florin DOBRE,** The Bucharest University of Economic Studies, Romania
E-mail: flndobre@yahoo.com
**Adriana Florina POPA,** The Bucharest University of Economic Studies, Romania
E-mail: adriana_fp@gmail.com
**Ada Lorena NICULIȚĂ,** The Bucharest University of Economic Studies, Romania
E-mail: adaniculita@gmail.com

that a company realized during a year. As a fact, the form of the audit report leads to misunderstandings from the stakeholders' point of view. For example, the first paragraph from the audit report presents the fact that the managers are responsible for the accounting practices and the way that the financial information is quantified by reference to these accounting principals. Moreover, the audit report points out that not an exhaustive evaluation of all revenues and charges or other accounting elements was realized, as auditor's activity is based on selecting a representative sample of each category. On the other side, the auditor has to point out an opinion about the entire activity of the company and about its financial statements. Frequently, the auditor's opinion is based on the fact on how the company actually respects the accounting's policy and moreover how it applies this criteria of evaluation. The auditor's opinion is the most important part of the auditor's report, but taking the several changes from the macroeconomic environment that happened in the last 10-15 years, questions about their credibility raises as it is better known that a favorable opinion can influence the stakeholders' attitude towards a company. On the other hand, the question that rises is if auditors provide a „bad opinion" about the financial situation of the company, would they be still trustful or not? The present article, tries to point out, some important researches in the field, while some recommendations are realized taking these references into account.

## 1. Literature review

The main literature is focusing on the importance of audit and of the quality of the audit provided, taking the influence of other elements into consideration. Salterio & Koonce (1997) points out how the auditors respond to precedents accounting situations where no guidance is provided. They illustrate that auditors usually refer to the precedent situation when evaluating an accounting problem no matter how the clients' position is. Moreover, they demonstrate that auditors tend to follow the client position when results of anterior problems are mixed. As a fact, the auditor independence and the accounting regulatory environment are influenced by past solution to accounting problems. Michaely & Shaw (1995) point out that firms with a good reputation (The Big four companies nowadays) tend to ensure a high degree of transparency and point out the mistakes encountered in the financial statements as they are more independent than the local firms. Moreover, Rahman (1998) reveals the same idea as these companies can eliminate the investors' fears regarding the evolution of the company due to their reputation as it is highlighted that they offer a high quality audit investigation. On the other hand, Francis (2004) reveals that the quality of audit is based on the audit failure's examples and that it can be increased by analyzing non only the financial statements for o company, but also its non-audit services for audit clients. Nonetheless, he reveals that the audit quality is positively influence by the earnings received, by the legal regime that exists in a country and by the reputation of the auditor. The audit report tends to be informative, no matter what the opinion of the auditor is.

Ruiz-Barbadilloa & Gómez-Aguilara (2006) investigate if long term audit contract provide a high degree of audit quality and if the auditors still remains independent. They discovered that long term audit contract determine a smaller degree of independency, while the company audited is not engaged in opinion shopping.

Another important question is how the audit is evaluated taking the economic crisis into consideration. Sikka &Willmott (1995) demonstrate that there have been important modification in auditing standards and codes of ethics due to previous financial crisis. Actually, the audit tried to improve its own performance as new financial problems regarding the audited companies were encountered. The readjustments of the audit standards were realized as compulsory measures in order to confer a reliable climate for the auditor’s opinion. On the other hand, Sikka (2009) reveals that the role of audit is questionable if recent events are analyzed, as these raise the suspicion that the auditors report lacks to provide an independent and objective opinion about the real situation of the company. The consequence was that many financial institutions either collapse or had to be associated to having an unqualified audit services. Contrary, Mitton (2002) marks out that the failure of the company is not mainly due to auditors, but rather to the company policy and to the degree of transparency that it offers to its shareholders. For example, the protection of minority shareholder interests lies in offering a high degree of transparency, a more favorable ownership structure and an important focusing on the corporate governance. In fact, all this policy elements are reflected in the companies financial statements and actually they influence the auditor opinion.

Humphreya & Loftb (2009) and Germain (2007) illustrate that the auditors have to be sensitive to the global financial architecture and moreover that different audit practices are correlated with the national and international context. Marchesi (2000) considers that failure audit reports are due to important differences in the competence required by auditors, their reporting obligations and the requirements regarding their audit reports. Moreover, in some countries the audit reporting is affected as no rules about the independence of auditor are presented on the national area.

Regarding the new expectations of audit, it has to be pointed out how proper audited financial reporting can influence the manager attitude towards the asymmetry of the information that they hold. As a fact, Ball (2001) marks out that independent verification and reporting of financial outcomes encourages managers to provide an accurate financial information. The proper hypothesis was tested by Ball & Jayaramanb (2012). They discovered that independent auditors’ activity is influenced by the management forecasting activity, and that the stakeholders confer a high degree of credibility to their audit report. It is considered also that the audit provides further information about the forecasting realized by the manager about the development plans of the company. Moreover, they reveal that the audit activity and the perspective of development of the company are somehow correlated, as audit financial reporting and private information can be complementary, but not interchangeable. It is also emphasized that there could be a connection between audit, performance and managers behaviors, a correlation that could be identified in the total quality cost of performance.

As it can be seen in the main literature, the conclusions about the audit role are somehow mixed. While some authors point out the importance of audit quality, the others accuse the audit practices as being the main factor that raises financial disclosure for the company. Actually, the real situation is somehow between these opinions. It is true that the audit quality influence the behavior of several shareholders, but actually unless a more detail report is requested at national levels, no relevant opinion about the audit quality can be provided. It is recommended that several changes have to be encountered in the audit report as these changes can confer a high degree of credibility for auditors.

Taking these elements into consideration, we consider that the auditor's profession is still sustainable as no other organization can provide another important opinion about the company financial statements.

## 2. The Green Paper – a document that can influence the audit profession's credibility

New improvement of audit quality was imposed by the Green Paper developed by the European Community. This document emphasis the importance of audit policy and also reveals the necessary of audit activity to consider the accounting principles that have to be kept.

The Green Paper is a document that acts like an auditing guidance that was developed by the European Commission at the end of 2010. The main purpose why this document was realized is based on the recent economic crisis and on the fact the auditors have an important role in the national economy, as they are authorized by the law to perform statutory audits. Their mission is actually connected to a social-economic function, as they have to present a reliable opinion about the credibility and precision of the financial statements of the company audited. The document also reveals that nowadays, there are auditing companies that play a crucial role worldwide, while failure of a company form this area (Big four companies) would have impact globally.

Moreover, the Commission considers that is essential for the biggest companies to have a continuous audit reporting and, nonetheless, that the audit market should not have any barriers for the new audit companies. As a fact, the relationship between shareholders, financial statements and auditors have to be revealed

Firstly, it has to be established how much information has to be provided to auditors by shareholders in order to draw their professional opinion. The auditors can address several questions to managers in order to get relevant information about their financial statements. The problems are somehow related to the fact that manager omit to present some relevant information as a negative opinion of the auditors can affect their future development. On the other hand, the auditor opinion should be in a deep correlation with the potential risks, the development of the sector or other risks: like the exchange rate, the influence of macroeconomic environment that can affect the companies financial reporting.

The Green Paper also emphasis that a better communication level should exits between the external audit and the internal one in order to illustrate that no discrepancies in evaluating the financial statements and the risk that has to be encountered exists.

Another problem regarding whether the auditors opinion is trustable or not, as they focus on historical data and sometimes they do not make a connection between economic environment and data presented in the balance sheet or profit and loss account.

Actually, an important change has been observed on the global level since the new International Standards on Auditing were implemented. The auditing companies try to offer a high degree of audit quality for the companies audited and moreover, a high degree of credibility to their audit report. Regarding these standards, and also the connection between them and International Standards on Quality Control, the audit should play a statutory safeguard role for investors, lenders and business counterparties who have interests in the audited company. As a consequence, the audit should be definitely independent from the audited companies. Moreover, the international standards should be applied in each country without exception in order to assure a credible role for the audit opinion at an international level as Negescu (2003) pointed out.

Nonetheless, the Commission wants to eliminate the problems between auditing firms and the revenues they receive, as well as those related to carrying out services that are not connected with the audit prerogatives. As a fact, the Commission proposes the compulsory rotation of the audit firms in order to ensure the objectivity and dynamism of audit activity.

Another important element of the Green Paper is focusing on the principles developed by the 22 Article for the European Norm, as it points out that no audit services should be provided if the independence of audit is affected due to other relations between the audit committee and the audited company. The problems lie in the fact that there is not a mandatory law about how this relationship is defined. As a fact, there is not a general rule applied on the European level, so, consequently, the audit practices can be trustable or less trustable according to the national legislation. Regarding the audited of an entire group that acts at international level, the auditors should have access to different reports and other financial information in order to form a proper opinion about the activity of the group.

With a high degree of importance is how the financial statements of audited company should be presented. As a fact, the transparency principle should be applied at all levels, including the corporate governance. The audit companies should try to diminish the conflicts of interests between stakeholders by establishing a better communication between shareholders and the other persons that have interests in company. Moreover, a more detail report should be presented in order to establish a proper and trustable opinion about the development of the company audited.

It is better known that the audit has to consider all kind of information that can provide additional key information about the companies' financial statements, no matter what the form of the information is. In this case, the Commission considers that it is necessary to exist a proper communication between auditing companies and stocks of exchange, as relevant evidence about internal fraud can be illustrated.

Moreover, the problems regarding the concentration on the audit market point out that companies that do not have an important role can provide audit report with a low degree of quality. Actually, the reputation of the company should not influence its opinion and moreover, the fact the company is having a small market share, do not necessary mean that the audit reports it trustable. Nonetheless, due to the high degree of concentration hold by Big Four companies, there is a high degree of systematic risk on the market. As a fact, the Commission wants to subtract the barriers that actually exist on the audit market.

In case of failure of one of Big Four companies, an emergency plan would be developed as the companies remained on the market should definitely insure that the audit is having a continuous activity. The international cooperation between states is essential and should be accomplished taking several elements into consideration. A global way of reporting should be realized and the general confidence between countries would provide a high degree of observation and surveillance of the audited companies. As a fact, the control of audit reporting would be realized at a global level. Moreover, the Commission would established with its international partners what other measures should be implemented at the global size in order to realize the control of auditing groups and of audit in general.

## 3. Discussion and recommendations on the sustainability of auditors' profession

Taking the main literature into account and the stipulation of Green Paper, several recommendations about the auditor's activity should be formulated. First of all, the auditors should be compulsory independent form the audited company as a more objective opinion can be formulated. Secondly, the auditors should provide a more detail audit report not only to shareholders of the company, but also to the general public. The justification is that by providing a detail report, more credibility would be conferred to them. Moreover, they also should analyze all elements that can affect the firm's profitability, as other elements like the exchange rate, the sectorial risk or the macroeconomic indicators can affect the financial statements of the company.

On the other hand, the auditors should also try to develop international reporting documents as a international collaboration between states would improve the credibility of auditors profession.

Actually, as no global standards exits about the audit profession, their audit opinion can sometimes lead to misunderstandings from the stakeholders' point of view. As a fact, in order to affirm that the audit profession is sustainable, several changes have to be realized on the audit market. The appearance of small audit companies, the independence of auditors, the details audit reports, the evaluation of financial and non financial elements and the inspection of elements from financial statements and also from external financial information it is compulsory to be implemented in order to ensure the evolution of the audit market and nonetheless, in order to improve the auditors credibility between different persons that have interested in audited companies.

## Conclusions

Taking the importance of audit into consideration and also that it is having a statutory role in the entire economy; the audit profession should imply several changes in their practices if the auditor profession should still be considered sustainable. The main literature points out that sometimes the audit is the main factor that influence the companies profitability and its the main factor that influence the companies failure, while other studies regard the limitation of audit profession as some information are unknown to them as the manager can adopt that accounting principles that assures him a minimum level of profitability as he benefits are high connected with it. Consequently, the auditor presents an opinion that is trustable regarding the financial situations of the company, but which is false if the entire economical environment of the company audited is considered.

In order to create a more sustainable background for the auditor profession, The Green Paper developed by the European Commission was adopted in 2010. With reference to this document, we propose some changes that would ensure the sustainability of auditors' profession as their activity cannot be omitted from any market. As a fact, the independence of auditors is required, a more detail financial report should be realized, a supervision commission that controls the audit activity should be created and moreover cooperation at international level is compulsory if the audit credibility on the market is desired to improve at global dimension.

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