FINANCIAL AUDIT REPORT- THE SOUND BASE OF THE MANAGEMENT DECISION

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ABSTRACT

The shareholders and the investors shall be informed about the actions of the company's management and their results. The management evaluation constitutes the base for the dialogue between managers and shareholders. The auditor is in charge with the evaluation of the degree of adequacy and implementation of the financial information performed for the management with a view to acknowledge the reality of the entity. The audit team and the manager shall be considered as partners not as opponents, as they share the same goals, namely the management effectiveness. The audit involves the checking of financial statements performed by an independent and responsible person, as well as verifying the compliance with the rules and the legal provisions. Auditing the financial statements is made up the credible evidence of the economic transactions. The aim of financial audit is to increase of the credibility of information provide by the financial statement useful for the future management decision.

KEYWORDS: *managerial decisions, financial information, the management's evaluation, financial audit, statutory audit, independent auditor, audited entity, objectivity and confidentiality, the investors, financial statements.*

Introduction

Financial crisis which have occurred lately, due to an adverse management or corruption has lead to a challenge in attracting sufficient capital. The investors have lost considerable amounts while the companies have dispersed their financial potential, all leading to an increase in the shareholders' activity and the competition for investments. Under these circumstances, the investors affirm they are not willing to accept the results of an ineffective management or the results of corruption. As the investors' interest is a top priority, they are entitled to require a sound management for their business. Moreover, before investing, the investors require analyses for the potentials businesses, in according to the efficiency and transparency standard of the financial statements. It has become an essential require for the national companies and for the developing economies to own the capacity to support the tests made by the international investors, as the investors are currently looking for and consequently choosing those companies with efficiency management.

The shareholders will be informed about the company's management actions and their results; therefore, they will be able to take appropriate decisions in terms of investments. Immediate knowledge of the adequate information can help to attract capital and to maintain the reliance in the capital market. On the contrary, providing insufficient information negatively influences both the entity with its shareholders as well as the whole economy, thus increasing the capital cost with a negative effect on resources allocation. The management evaluation sets up the base for the dialogue between managers and shareholders. The evaluation allows the managers to learn from their experiences, consequently increasing the capacity to take and to implement effective decisions. Thus, evaluations become a dynamic and continue activity for effective managers.

The audit – introductory notions

The responsibility of the auditor lays in the evaluation of the degree of appropriateness and applicability of the financial and non-financial controls, ordered and performed by the management with a view to increasing the activity efficiency. The auditor is also responsible for the degree of appropriateness and applicability of the financial and non-financial information aimed to the management in order to facilitate the knowledge of the entity real data.

The auditors and the managers should be regarded as partners and not as competitors, both having the same goals, among which the efficiency of the management activity as well as achieving the proposed targets. The managers have to understand the auditors' recommendations, to appropriately understand the support they get, aimed to diminish the risks which continuously appear and grow. The audit, namely the examination of the fidelity of accounting and financial data, performed by an independent and competitive person, is the key for the probity and credibility of economic transactions[1]. The audit is a professional examination of a piece of information, with the view of expressing a responsible and independent opinion, through reporting to a criteria or quality standard[2]. The audit term, which has an Anglo-Saxon connotation, mainly covers the same meaning as control or checking, but it is also the one often associated with concepts like ***quality, rigorousness, modernism and qualification***[3].

The economic and social organizations have always provided accounting financial information. The necessity to verify this information implies a control of the accounts, their revision, as well as a critical check performed by independents professionals. Performing each audit operation on economical units involves certain regulations which are precise, formalized, known and accepted by both the issuers and the receptors of the information to be the subject of the audit. These rules are defined at the national or international level. Therefore, the notion of regulation is reached, thus allowing the appreciation of an audit as reported to a reference system[4]. The extern audit is often preferred if considering objectivity, accuracy, as well as increasing the internal and international investors' trust or even the unit management. The extern audit is an independent activity aiming to certify the plausibility of financial-accounting documents. It implies the independent, professional and qualified control performed by an auditor and aimed to verify the respective documents. The auditor who checks the client's documents accuracy must be entirely independent. He

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[1] Mircea Boulescu, M Ghiță ,V. Mareş *The Audit Foundaments* Publishing House. Didactică şi pedagogică, Bucharest, 2001 p 9

[2] Ioan Opreanu *Drafting and Auditing the Accounting Balance* „Întocmirea şi auditarea bilanțului contabil", Editura Intelcred Deva, 1997

[3] Gh.D. Bistriceanu, C.G. Dumitrescu, E.I. Macovei – *Finance-Credit, Accounting, Financial-Accounting Computer Lexicon* (Lexicon de finanțe-credit, contabilitate şi informatică financiar-contabilă), vol. I, Publishing House Didactică şi Pedagogică, Bucharest, 1981, p 2

[4] Dan Vilaia, Ion Scarlat, Ion Mihăilescu – *The Accounting Expertise and Financial Audit* Expertiza contabilă şi audit financiar, Editura Independența Economică, Piteşti, 2000, p 88

is not an employee of the entity and his actions are not influenced by any of the management's control. The management must establish and implement appropriate accounting measures, to set up an effective accounting control aimed to defence the assets, as well as to elaborate an internal control system, able to assure the satisfactory drafting of accounting-financial documents.

The statutory auditor (the independent auditor who performs the audit of the yearly consolidated financial statements) reports to the management with a view to the essential aspects to result from the statutory audit and especially to the significant deficiencies of internal control in terms of financial reporting.

The cheking of financial statements

The main objective of the financial audit is to check the veracity of financial statements, considering the accurate, clear and complete side of information and operation, with a view to expressing independent and responsible opinions. The audit's targets are those results to be expected after checking the financial statements.

Establishing the specific targets is a necessary phase in planning the financial audit, depending on which the area of the audit applicability is decided.

The financial audit has the following ***specific targets***:

✓ To identify the veracity of the assets statements and the financial results in yearly financial statements, which have to draft an accurate image of the financial position, financial performance, treasury flows as well as the other information related to the run activity;

✓ To express opinions, part of an audit report which will include the correct auditor's opinion on the accuracy of the financial statements in compliance with the general frame of financial reporting and, if the case, to mention if the financial statements observe the statutory requirements; To maintain[1] the quality and the coherence of the accounting system, thus assuring the accuracy of the balance registrations and of the profit and losses account, rightfully and completely reflecting assets, the financial figures and the results of the exercise;

✓ To assure the improvement of the use of accounting information;

✓ To verify the management' assertions in terms of financial data;

✓ To appreciate the performances and effectiveness of the information and organization systems[2];

The management's assertions referring to financial data are the affirmations of the entities' management, explicitly or implicitly expressed, which are part of the financial statements. By signing financial statements, managers declare and take responsibility as referred to the information included in the respective statements.[3] Part of the audit process, the auditors verify if the information included in the financial statements are in compliance with the assertions. There should be noted that there are specific assertions both for transactions (operations) registered in the accounting financial documents, and for the balance accounts.

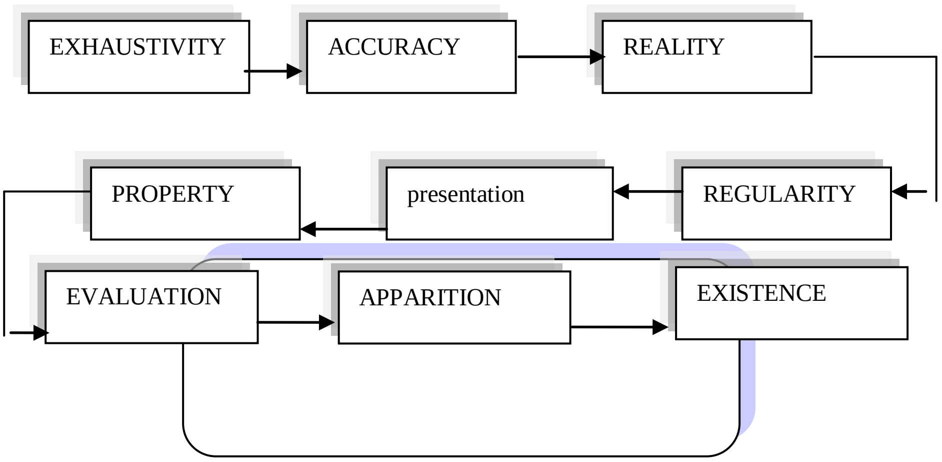
[1] C. Afanase – *The Accounting Financial Audit,* Audit contabil financiar, Publishing House. Universitatea „Dunărea de Jos" Galați, 2004

[2] M. Boulescu, C.Bârnea, quoted., p.13

[3] RAF nr.1/2001, quoted., p.63

The following chart shows the several management assertions and the questions a financial auditor may ask referring to them:

- **Management's assertions on financial statements**



ASSERTION	DEFINITION	QUESTIONS	EXEMPLE
EXHAUSTIVITY	▪ all relevant operations have been registered; ▪ all the assets and liabilities from a certain period have been registered;	Has the operation been registered in the accounting?	The manager uses an available account with 2 billions RON to spend on various expenditures. The expenditures made onthis account during the year have not been registered in financial statements. The Financial Manager;s business car, property of he audited unit, has not been registered as a fix asset. The fix assets balance is incomplete.
Accuracy	▪ all operations are accurately declared;	Has the operation been registered on its correct value?	A manager bought some equipment from the US, and the rate exchange RON/USD was wrongly registered.
Reality	▪ all the registered statements are real.	Has the transaction correctly been registered in the chapter of the expenditures account in the financial year it was made?	One manager pays in advance for a conference to be held in January of the following year with the purpose to spend the budget before the year's end.

ASSERTION	DEFINITION	QUESTIONS	EXEMPLE
Regularity	▪ all the operations are in compliance with the in force laws and regulations.	Is the operation legal and in compliance with the in force regulations?	A manager spends money on equipment which are not included in his approved budget and which have not been bought according to the acquisitions' regulations.
Presentation	▪ all operations are classified and described according to the regulations. ▪ all assets and liabilities are presented, classified, and described according to the in-force reporting frame.	The operation is correctly codified and presented. Is the article correctly presented?	The human resources costs on December have been registered in a different account which had available budget at the end of the year. A car has not been registered as a fix asset but it has been presented as an asset in the debtor account. This is the reason why the fix assets balance is not accurate.
Property	The assets and liabilities registered by the company do not belong to the respective unit.	Do the assets and liabilities belong to the unit?	The Executive Manager's business car was bought in leasing from a local licensed dealer. However, it has not been registered as a fix asset of the unit, when the leasing ended.
Evaluation	The assets or liabilities are evaluated according to the adequate accounting policies, consistently applied.	Has the article been registered on its correct value?	A car has a net registering value of 2 billion RON. However, due to its frequently use by the Financial Manager, it has been evaluated at 1.5 billion RON, thus the fix assets balance being over-evaluated.
Existence	Assets or liabilities included in the financial statements exist at the balance date.	Did the article exist on the balance date?	A car has been registered, but has been sold before the balance was made. The final balance of the fix assets has been over-evaluated[1].

[1] Romanian Court of Account, *Financial Audit and Regularity* (Manual de Audit Financiar şi Regularitate) Bucharest, 2003, p 25

In case the auditor gets enough audit evidences referring to the objectives that have been determined on the base of the management's assertions, he will satisfactorily be ensured that the financial statements are accurately set up.

Auditing the financial statements is the auditor's responsibility

The auditors should identify, analyze, evaluate and record sufficient information to achieve the engagement's objectives. The responsibility of the auditors is to audit the financial statements in order to express an opinion about this. The statutory auditor must be independent of the audited entity and can not be involved in any way in the decision-making of the audited entity. The audit work papers must contain documentation of all significant threads to the auditor's independence as well as the safeguards applied to mitigate those threats.

When the financial statements do not comply with in force laws and rules, they can produce a significant effect. Inconformity is a term used for referring to omissions or any acts belonging to the audited entity, being they deliberately or not, which are opposite with laws and rules in force. Lack of knowledge about laws and rules can have as result financial consequences for the entity, as penalties, litigations, etc. In general, if the omission is farer from the events and the transactions which have been reflected in the financial statements is unlikely that the auditor will identify or recognize an omission.

It is the management responsibility to ensure that the entity's transactions perform in according with legal rules and provisions, to apprise and to detect any disaccords. With a view to preventing and identifying inconformity, the management can be supported by politics and procedures, such as:

- to comply the legal requirements and to ensure that the operational procedures are meant to accomplish this requirements;
- to establish an adequate internal control system and to ensure its functioning;
- to develop, publish and respect a behavior code;
- to provide an adequate training for the employees and an optimal understanding of the Behavior Code;
- to verify the compliance with Behavior Code and to perform an adequate activity for its understanding;
- to engage the legal advisors aiming to supporting the compliance with legal provision;

In order to evaluate the potential effect of the probable nonconformity on financial statements, the auditor takes into consideration:

- occasionally financial consequences: penalties, damages, litigations, the danger of assets' expropriation, the forced cessation of activities, litigations;
- if necessary, to present the information referring to eventually financial consequences;

If the eventually consequences are so grave, that they threaten to question the accuracy of the presented in the financial statements.

The auditors should communicate the nonconformity results to the management, to the report's users as well as to the regulatory and executive authorities.

Taking into consideration that the management is responsible with the financial statements adjustment aimed to correcting significant misstatement it is important for the auditor to obtain the written statements from the management according to which, any uncorrected misstatement which have produced of forgery, fraud, are, in management opinion, insignificant both considered single and cumulated.

The financial audit report

The auditor should revise and evaluate the conclusions that result from the audit evidences obtained as base for expressing an opinion on financial statements. The audit report should express the auditor's opinion clearly. In addition, he should evaluate if the financial statements were established in compliance with an identified standard accounting system.

The second stage set up by the general accepted audit standards takes into consideration the evaluation of the internal control, of the objectives, procedures and documents. This level also considers the evaluation and capitalization of the conclusions and procedures forwarded to the managerial team. It is necessary for the auditor to identify the procedures used by the internal control, the manner to collect the audit evidence and verify the financial information, to verify through compliance test to regulate the procedures, to identify the existence and the size of audit risks.

The auditors should communicate the engagement results to the senior management. An audit team can work effectively only if it gets full co-operation from the management.

Conclusions

The modern management cannot be conceived without a rigorous and flexible control. The management imperatively involves a permanent and systematic control of activities run within a patrimonial unit.

Managers have the responsibility towards the shareholders to elaborate solid decisions related to development strategies, profitability, the turnover's growth, etc.

The financial auditors' task is very important in the society. The wide area of users of accounting information through public (investors, employees, creditors, debtors, financial institutions, government) considers the validation of annual accounts achieved by professional financial auditors in terms of accounting technical instrumentation and an accurate financial reporting, an efficient financial management and as competitive consultancy for a wide area of business.

In order to meet these challenges belonging to financial auditors, their attitude and behavior in the process of providing professional services influence the economic prosperity through the decisions to be made on the base of their reporting credibility.

The auditors are commonly interested by the frauds which may significantly influence the financial results as well as the performance reported by a unit. Taking into consideration the fact the auditor cannot verify all transactions, he will mainly select the risky ones, susceptible to generate errors or frauds.

A study performed by Nobes C. (1995) revealed the fact that the task of the external audit is currently to check if financial reporting faithfully provides the financial status, performances and treasury flows engaged by an unit, even if, initially, the external audit used to deal with detecting and preventing frauds. It is well known the fact that the most frauds have been identified as a result of external verifications performed by auditors. Therefore, the auditors' tasks to identify accounting frauds must increase, aiming to discovering these frauds in an incipient phase, before having been too late and nothing being left than to state the unit's bankruptcy.

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