

## FINANCIAL AUDIT – UNDISPUTED SOURCE IN PRECISE INFORMING OF FINANCIAL STATEMENT'S USERS

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*Financial audit implies a methodology of assessment to ensure an independent opinion so that to equally protect all the users of financial information: shareholders, state, employees, banks, stock exchange, debtors, suppliers, clients etc. Financial auditor answers to the third parties needs in relation with the confidence degree they can grant to the financial accounting documents of the company.*

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### 1. Introduction

Financial audit implies a methodology of assessment to ensure an independent opinion so that to equally protect all the users of financial information: shareholders, state, employees, banks, stock exchange, debtors, suppliers, clients etc.

Actual and potential investors are interested of the inherent risk of transactions and the benefit brought by their investments. The main information refers to the assessment of company's capacity of paying dividends, which is why by means of the audited financial statements investors want and get information regarding patrimony, profit size and manner of division. All these information lead the investors to optimal decisions concerning investment policy, respectively to choose the best alternative between go on buying, keeping or selling the shares.

Employees and unions are interested of information related to company's stability and profitability, assessment of company's capacity to ensure salaries, pensions, professional opportunities etc. Financial creditors are generally interested of information concerning company's possibility of reimbursing in due time the

received loans and to pay the interests, respectively of new credit opportunities. Clients are interested in information about continuity of a company's activity on short and long term as well, in a manner which essentially depends of the dependence degree (from the point of view of commercial relations) towards that company.

State and its institutions are interested in collection and allotment of the budgetary resources, to this effect supervises the company's activity and determines the National Income, Gross Internal Product or other macroeconomic indicators. This supervision depends of the character and policy of each state (mainly of the centralized or decentralized manner of management and control, respectively of the predominant nature of the properties on companies – of state, private or combined, but also of other factors) and has as scope the development or inhibition of some sectors of activity by means of fiscal policies.

The public is interested about companies in relation with the numbers of employees and cooperation with local suppliers. Financial statements can help public to assess the present and future evolution of the respective

activity sphere and its financial potential.

Managers responsible with drawing and submitting of financial statements aim to get some comfortable financial results so that their activity to be positively considered but in the same time to keep financing resources, respectively abatement of dividends.

## 2. Audit's objectives

The audit has as objective the followings:

- reflection of the true image of patrimony's statements and financial results in the balance sheet and profit and loss account;
- expression of an opinion to know if financial statements present a true image of **assets, debts, financial position, profit or loss of company** in compliance with law in force in the country in which is resident;
- keeping on quality and coherence of accounting system so that to ensure confidence of an accurate, authentic and complete reflection of the patrimony, financial statements and results within the profit and loss account;
- improvement of accounting information use;
- assessment of performances and efficiency of the information and organization systems.

Financial audit is invoked to express an independent and objective opinion on financial statements, based on the professional judge, *so that to equally protect all the users of financial information mentioned above.*

Financial auditor answers to the third parties needs in relation with the confidence degree they can grant to the financial accounting documents of the company. From the point of view of the users of the audit reports it is important to be emphasized the main characteristics of this activity as follows:

- external or independent audit suppose the existence of the extern auditor as an independent qualified professional to examine and certify the accuracy of the financial accounting documents; on this

base the extern auditor shares the followings liberties:

- acts in absolute independence to perform control in order to certify the accuracy of the client's financial accounting documents;
- he is not an employee of the company;
- his acts are not controlled by the company's management;
- has limited responsibility on expression of his notice on the financial accounting documents he is examining;
- the financial accounting documents are declarations of the company's management which has the followings obligations:
  - to adopt proper accounting practices;
  - to organize an efficient accounting system for assets reflection and protection;
  - to elaborate an internal control system to concur to ensuring of adequate drafting of the financial accounting documents;
  - to take on responsibility for the accuracy of the information presented within financial accounting documents;
- analyses the financial accounting documents according to general accepted standards and includes all the necessary procedures;
- provides control by spot-check so that:
- his findings do not reflect an absolute assurance;
- expressing an opinion is the extreme limit the auditor can reach;
- when expressing the opinion on the financial documents, the independent auditor shows if these documents present satisfying information according to general accepted accounting principles;
- he presents the opinion as a report (written document) which represents the certification that the financial accounting documents are correct;
- this certification is just an expression of an opinion and not an absolute guarantee, except the documents totally affected.

In achieving the mentioned objectives a main role comes to qualitative characteristics

which represent those attributes making that the supplied information within the financial statements to be useful for its users. In absence of some useful and exhaustive information, even the managers will not be aware of the real financial statements of their company, and other key users can be misguided and this fact can block the functioning of market order. Complying with main qualitative characteristics and proper accounting standards leads generally to financial statements presenting an accurate image.

This utility of information is given by the following characteristics:

✧ *Intelligibility*, which suppose that financial information within financial statements to be easy to understand by a large variety of users with sufficient accounting knowledge in the company's activity; presentation of financial information have to satisfy also users with minimum knowledge in the area as well as those who need complete information hard to understand for certain users; for example, the expression "*financial statements present an accurate image of the position and financial performances of the company*" was interpreted by a state authority meaning that the company had special financial performances over against information within financial statements – meaning which is not according to what the financial auditor wanted to express;

✧ *Relevance* is information's ability of influencing users decision which leads to assessment of past, present and future events. Hereby the information about assets and liabilities structure are considered relevant for the users predicting company's ability to have the best of opportunities and to eliminate potential risks and on the other hand there are usually irrelevant for users analyzing marketing policies but for these will be relevant information about company's reorganization;

✧ *Significance threshold*, depending on element or analyzed error size in terms of omission or a mistaken part of financial statements, represent the limit beyond the value of the presented error can influence in a negative manner the decision of users;

✧ *Credibility of information*, for which this have to consider the accurate representation of transactions and events materialized in assets, capital elements, obligations and results, all these having to fulfill the criteria of appreciation; in this respect the transactions and events presented by accounting information must be in accordance to economic reality and not just to their legal form and in the same time to include a caution degree for assessing the assets and incomes in terms of incertitude. Information within financial statements have to be neutral, clear and complete in the reasonable limits of the significance threshold and due costs for obtaining those information;

✧ *Comparability*, meant to offer a better image of financial statements, allows identification of differences between accounting policies applied in different periods as well as of tendencies in the company's financial position and performances.

### **3. Types of audit opinion**

From the point of view of type of financial reports drafted by financial auditors and of the perception type on users, there are the following opinions:

**Unqualified opinion** (without reserves) – issued when auditor reaches the conclusion that financial statements offers a true image or are correctly represented in terms of all significant aspects according to the identified financial report framework (national, international etc). To express this opinion, the auditor uses one of the following formulas:

- "Offers a true image" or
- "Presents in an accurate manner all the significant aspects".

This type of report increases the credibility of financial statements, offering a high level of assurance but not an absolute one. Users should pay attention that this opinion is not an absolute guarantee of company's future viability neither the guarantee of the company's management efficiency (given statements being influenced by favorable

extern factors but for the moment). Referring to the insurance offered by auditor, insurance which should be understand as satisfying auditor's exigencies related to credibility of some assertion issued by one party in order to be used by other party, the user should consider the followings:

- for issuing such insurance, the auditor assess the evidences from the performed procedures and on this basis formulates a conclusion;
- the achieved satisfaction degree as well as the given insurance level are determined by quality and exhaustiveness of audit procedures and their results;
- a total insurance within audit is practically impossible to offer for these reasons:
  - implication of professional judgment which notwithstanding is based on logic it still can lead to partially or totally mistaken conclusions, according to some professional elements such as professional quality of auditor and quality of audited system;
  - the used tests were not the most efficient ones;
  - the inherent limitations of accounting or intern control system within audited system;
  - assertions of audited company's management regarding existence/inexistence of some rights or obligations, respectively of some transactions, in other words related to comprehension.

**Qualified opinion** (with reserves) – issued when auditor reaches conclusion that can not issue an unqualified opinion, but in the same time the effect of any misunderstanding with management or limitation of applicability area is not so significant and comprehensive to lead to a contrary opinion or to impossibility of issuing an opinion. Above mentioned aspects on the first report type (without reserves), in terms of qualified opinion the user should consider that auditor performs such report related to:

- requirements of standards applied to objective as well as requirements of other general principles governing an audit of financial statements (independence,

integrity, objectiveness, professional competence, confidentiality, professional conduct);

- requirements of professional bodies he is part of;
- requirements of legislation in force;
- requirements of contractual engagement;
- type of report.

**Adverse opinion** – issued when the effect of a misunderstanding is so significant and comprehensive for the financial statements that the auditor reaches conclusion that a qualified report is inadequate to present information related to incomplete or mistaken nature of financial statements.

**Impossibility of issuing an opinion** – when auditor could not follow and confirm significant aspects on audited financial statements, because of limitations of the audited accounting system or limitations compelled by the company's management. In this case too, the auditor's report should presents limitation and indicates to the users the possible adjustments of financial statements which could have been determined if no limitation.

Except impossibility of issuing an opinion, in all the other above mentioned cases the users are usually satisfied (with the performed observations) in what concerns audited financial statements and can take decisions according to their interests.

Each audit mission evolves according to some straight rules which are known, accepted and respected by both auditor and audited. The mentioned rules are developed by specialized bodies acting on national, regional and global level.

In the present time, "STANDARDS OF AUDIT – ISA" are of good repute and their use is more and more extended. European Union embraced too the idea of adopting these rules by the member states in 2005, and on 21 May 2003 European Commission issued a notice called "strengthening of statutory audit in EU". This notice settled as short term priority adopting of ISA for legal

audit missions.

The success of that implementation depends on certain preliminary actions such as:

- actualization and completing of the analyze of differences between ISA and national standards of audit;
- developing of a set of principles (conceptual framework) for ISA assessment;
- assessment of possible adopting systems;
- achieving of a common audit report;
- existence of some qualitative translations in all EU languages.

We shortly present the most significant practical initiative proposals to be put in practice in a near future: *Starting 2005 the use of ISA for all statutory audits within EU, as a main condition of increasing the quality of the audit process.* This objective was set as a result of some careful researches performed by the EU Audit Committee, since 1999, regarding audit requests within member states. The studies underlined that there is a high degree of convergence with ISA but still there are necessary some completions such as drafting a standard for the international groups, updating the risk model within standards as well as editing an audit guide based on ISA.

In the same time, it is considered by the formalizers that achieving of the mentioned objective will be considerably influenced by the manner of development of the preparing actions. Although it was set the term for the use to become binding, it was not developed the instrument to compel this binding.

#### **4. Public survey**

✧ *Granting a special significance to the public survey, as a major element to keep public's trust in audit.* This step is more necessary in the present, when public perception on auditors was seriously affected as a result of financial scandals. For achieving this objective it is considered to settle down some surveillance bodies to include a majority of non-partisans. Also it is emphasized the necessity of making a coordinating mechanism within EU for all

the surveillance systems on national level so that to be made an efficient pan-European network. In the same time, the responsibility for practical implementation of the surveillance within national systems will be a task for the member states, following that on the level of union to be appointed a committee to perform just the convergence of principles and practices in this respect.

✧ *Ensuring of quality by means of a proper system thought in this respect represents a requirement in intercommunion with public surveillance.* Hereby on the level of EU it will be implemented the stipulations of The Recommendation concerning quality insurance for the statutory auditor within EU, issued on November 2000 by the Commission.

✧ *Strengthening of disciplinary sanctioning systems in order to increase public credibility.* It can be noticed in this context the high accent on convergence of the disciplinary procedures set up within member states and lower accent on systems harmonization, in view of legal and judicial differences on national levels. As a new measure we mention the setting up of obligations to exist a proper cooperation in the trans-border cases.

✧ *Increase of transparency of audit companies and their network is also an objective linked to public perception and its trust degree increase in the audit function.* Now there are a series of fears about international networks which include various audit companies, because it was found that there is significant low control level of the network as a entity on the individual companies which form it and as a result it can be very difficult to set up straight responsibility within network.

✧ Supporting the set up of audit companies within EU by reducing the requirements related to property, under the reserve of the limits for protecting auditors' independence. In this context it is appreciated that it should be supported the set up of audit companies completely integrated within EU by reconsideration of the management and

property requirements on the level of member states. Besides starting January 1, 2007 we are not anymore Romanian auditors but European auditors. For this fact it should be considered the major objectives - strengthening of quality control, public surveillance and transparency.

◇ Careful study of audit market structure and access on market for the EU audit companies is a major concern of Commission.

◇ In the view of many specialists within EU, the compulsory use of ISA would lead to creating an international market for the audit services and as a result would ensure international mutual appreciation of audits, at least for European level.

◇ In the same train of ideas it is to underline that all regulating and modernization action for the audit will be significantly quicken and influenced by moving the accent from harmonization to convergence.

### **5. Conclusions**

This last aspect is very important and will have a strong impact as regards improvement of audit normalization in our country so that to be ensured not far long the convergence with the audit on European level. In order to achieve such challenge it is appropriate that national bodies, but first of all the Auditors Chamber of Romania which has legal competence, to show permanent and strict concerns as for both cooperation with EU and international specialists and a continuous improvement for the legal framework of financial audit within Romania.

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