

NEW CHALANGES FOR THE FINANCIAL AUDIT IN THE CONTEXT OF MEASURES TO SURPASS ECONOMIC-FINANCIAL CRISIS

Țară Ioan Gheorghe

University of Oradea The Economic Science Faculty 1, University Street, Oradea E-mail: ioantara@yahoo.com

In order to find the antidote of the actual economic and financial crisis it is necessary to know the real causes that brought it about. Many companies and banks reached collapse or are closely there due to various ranges of reasons but among them there are those which are connected to a certain lacks of transparency regarding their financial going. One can say that financial audit and auditors as well should have been much more involved in the prevention process. We refer to both their professional and ethic standards and the principals of enforcing them. Some proposals were made by IFAC regarding to both these aspects. How they might be added to is the following: new principals in financial audit independence, new responsibilities for auditors in going concern analysis and, perhaps, in fraud and error competences.

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Introduction

The actual economic and financial crisis has, undoubtedly, many causes. It started with banking and insurance system and has gone on with the companies from different fields. There are questions to get answers such as: how was it possible; are there anybody guilty; which the causes are and what is to be done so that the effect upon the people to be not too long in time and as much as possible less damaging as well.

All this period long the political leaders as well as the representatives of the economic and financial organizations widely discussed upon the subject of the means to stop the crisis course. Among the means they found money coming from the state as being a good one. There are different ways to do so but it ends-up in affecting the people's financial comfort. We can see, as a result, even changes in ideological thoughts of some public opinion-makers and also in the people confidence in the financial system.

There have been fewer debates and correspondently not enough ideas about the causes of the certain banks or big private companies' bankruptcy. Therefore, we consider that it is need for honest debates upon the real causes and the contribution should come rather from professional organizations than from the political world.

Could financial audit, in its organization and exercising, be one of the causes?

In our opinion categorically not or, at least, not the main cause. Although it might have be a better lever to prevent the wrong course of some companies' financial situation if its professional standards were more effective applied. In some respect the economic and financial world needed more transparency in revealing the basic of financial information and also a better organization of what is called "internal control system" and "risk management system". The standard of financial audit refers to such domains and there have been made proposals to improve the methods for enforcing them.

The International Federation of Accountants (IFAC) issued the International Standards of Audit (ISA) which financial auditors refer to in their activity. There have been also issued other rules and standards²³⁶ as far as accounting activity and reporting system are concerned. Along the time there were issued recommendations to all economic and financial organizations, including the majority of countries, on how to improve their accounting activity and what to do in enhancing the transparency. It is to have been applied only.

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To assist professional accountants in addressing issues related to the global financial crisis, IFAC and the International Auditing and Assurance Standards Board (IAASB) have focused on three activities:

- To increase awareness among preparers and auditors of existing and newly developed guidance that can assist them in reporting on financial instruments;
- To encourage further convergence in reporting standards on financial instruments, while at the same time strongly supporting (the continuation of) fair value accounting since reducing transparency is not in the interests of investors; and
- To participate in and promote discussions of best practice with respect to the audits of financial institutions and other organizations that are affected by the current crisis²³⁷.

Recently IFAC, as a professional organization, submitted recommendations for the reform of the global financial system to the G20 Working Groups that met during the 2009 London Summit. We are going to cover this subject in another chapter.

The Financial Audit-concept, goal, types and organizations

According with International Standards of Audit (ISA 200) the financial audit consists in verification and certification independently carried out by a responsible professional as far as annual accounts and financial statements of any company are concerned aiming at expressing his opinion connected to the reality of information issued by these companies' synthetic documents.

The financial audit role, as an independent examination and expression of opinion on the financial statements of an entity, is to report on the truth and fairness of the financial statements on behalf of their users. That means the auditors give an opinion whether the financial statements are prepared in accordance with an acceptable financial reporting framework (e.g. international standards of financial reporting) and with any specific statutory requirements (e.g. rules and laws).

In order to accomplish such a goal the financial audit activity and the auditors have to comply with some basic principles of ethic that are required by the Ethic Code. Both the activity and auditors themselves must be **independent**. The fundamental principals stated by The Ethic Code are the following: integrity, objectivity, professional competence and due care, confidentiality, and professional behavior.²³⁸

It is not our purpose to detail the principals here but we want to stress the importance of an independent financial audit activity so as the opinion of the auditors to be believable and, as a consequence, really useful.

Using different criteria one can identify several types of financial audit activity. In our opinion two of them are extremely important in order to cover the independence task. Thus, taking in account the organizational position of the activity one can talk about internal audit and external audit. The former is organized inside of any entity that requires it to respond to the interests of that entity management. Being an employee those auditors are materially connected to the management interest and therefore, not always the objectivity can be real. It might be a relative independence. The external financial audit is an activity that comes from outside of any entity, the auditors are not any more employees and, as a result, they are seen as being more objective. The independence seems to be more real. But what about the material interest that interferes the contractual relation between an auditor that provides a service and a company that pay for that? Objectively, some threats of the independence might appear. An idea for a solution to improve the independence of the external audit exercised by direct contract relation, especially when it is about big companies with a certain public impact, is to be put forward further.

237 <http://www.ifac.org/financial-crisis/>.

238 Federatia Internationala a Contabililor, Camera Auditorilor Financiari din Romania – “Audit Financiar 2006, Standarde, Codul Etic”, Editura Irecson, Bucuresti, 2007.

Another criterion to classify the forms of financial audit would be the organization the auditors belong to. By this point of view there is financial audit exercised by auditors belonging to followings: entities (internal auditors), professional organizations and supreme audit institutions. The last two forms appear as an external audit because they come from outside of any entity. The difference mainly consists in the fact that The SAI (supreme audit institution) usually belongs to The Parliament and exercises financial audit on the public funds. There is also a very useful difference between the professional organizations audit and that of the SAI. Namely there is no material connection between those two parts as long as the financial audit activity are compulsory exercised on public agencies and without any direct payment. That means a bigger objectivity and a real independence.

IFAC recommendations to G20 Group, April 2009, Summit

As a professional organization compounded by 2.5 million accountants coming from 122 countries The International Federation of Accountants has acted responsibly to help political leaders to make the best decisions for surmounting the difficulties of financial and economic crisis. Therefore we consider that the financial audit activity might be an effective lever to increase the thrust and transparency as conditions either to prevent or to escape crisis.

As far as financial audit activity of The IFAC is concerned there have been identified at least two directions this institution has worked for:

- It issued some new guidance to help auditors improving their activity.

- It submitted recommendations to G20 Group, as an international political organization with the unique possibility to enforce them, in order to help the countries in a better organization of the financial and economic life. This opportunity was taken in April, 2009 when took place “The Group of Twenty (G-20) Finance Ministers and Central Bank Governors Summit “.

Those new guidance refer to also new problems the auditors have to cope with as a result of these challenges brought about the crisis. There have been issued: “Audit Practice Alert on Going Concern Assumptions” and “**Audit Practice Alert on Auditing Fair Values**”. Both of these guides offer to the auditors the best practice example on the probably some of the real causes of the certain banking and insuring companies’ bankruptcy such as: a worse deal with going concern assessment and a wrong estimation of provisions. The auditors should, probably, have worked better with the concepts like “going concern” and “fair values estimates”.

On the other hand IFAC sent to working groups of G20 recent Summit some recommendations that had been asked previously and were designed to support the leaders in developing the best solutions that lead to a more stable financial system. They refer to: “**Enhancing Sound Regulation and Strengthening Transparency**”, “**Reforming the IMF**”, “**The World Bank and Other Multilateral Development Banks (MDBs)**”. With a little more details the recommendations look like that:

- the G20 countries to adopt International Standards on Auditing (ISAs) where they have not already done so, and urge their adoption in nations and jurisdictions.

This will assist:

- (a) the G20’s goal of strengthening transparency and accountability in the context of the audit of financial information; and

- (b) national and jurisdictional regulatory systems in the interpretation and exchange of audited financial information.

- to adopt and implement (in letter and spirit) the Organization for Economic Cooperation and Development’s (OECD) Principles of Corporate Governance as the standard framework for corporate governance, and urge its adoption in other nations and jurisdictions.

- the G20 countries act to ensure that sufficient resources are applied to develop and disseminate implementation guidance for all global standards that they adopt/support, such as ISAs, the

OECD's Principles of Corporate Governance, the International Financial Reporting Standards (IFRS), and all others of the Financial Stability Forum's (FSF) Compendium of Standards.

- call for the establishment of an international, principles-based threshold of competencies for senior financial officers in public interest entities. This should emphasize, inter alia, training in corporate ethics, knowledge and application of financial reporting standards, continuing professional development, and familiarity with the national governance codes, and other regulatory rules and procedures.

- the countries should consider reforms of enterprise risk management systems and senior corporate remuneration schemes, as both may adversely affect sustainable business performance.

- the members of G20 to advocate the implementation of high quality models of governance for all international institutions with mandates to set financial regulation. Such models should be built upon principles of public oversight, accountability, independence and transparency – all of which are in the public interest.

- the countries to adopt International Public Sector Accounting Standards (IPSASs) where they have not already done so, and urge their adoption in other nations and jurisdictions.

- the G20 acknowledge the importance of the small business sector and ensure that any agreed policy actions are supportive of this sector.

- the G20 to require that the International Monetary Fund's (IMF) Code of Good Practices on Fiscal Transparency to be strengthened through the application of International Public Sector Accounting Standards (IPSASs).

- the G20 to support the IMF/World Bank Reports on Observance of Standards and Codes (ROSC) initiative

- the G20 to support the World Bank and other MDBs in their efforts to assist countries to improve their financial management capabilities and strengthen the financial reporting infrastructure. This would include facilitating the establishment and strengthening of well-governed national accountancy bodies where they do not exist.

- the G20 to support the World Bank/International Monetary Fund (IMF) Reports on Observance of Standards and Codes (ROSC) initiative.²³⁹

As we can see financial audit activity is actively involved in improving its methods of prevention the irregularities and in developing solution to make financial system healthier. We do not want to comment these proposals, we just say they exist, they have appeared and if they were applied the results would be certainly favorable. At the same time, further debates on the subject should take place because, we believe, the financial audit still has reserves for increasing the public control upon all the entities' financial statements.

The possible ways to increase the quality of financial audit

As we have already assumed the problem of financial audit independence should be a subject that debates might still take place on. It is about both internal and external audit. The more independence of financial audit the better transparency as far as financial and economic activity of an entity is concerned.

While the independence of the internal audit is almost unanimously acknowledged as being a relative one and, as a result, it is to work with some objectively limited competences, the things are different in the external audit case. Therefore, we think of improving the independence of the external audit as a method to enhance the transparency and public control of the economic and financial processes both at the macro and micro economic level. Particularly we have to refer to those big financial organizations (banks, insurance companies) and also to the world wide developed economic companies from different fields. Why? It is so because, on the one hand, they are that type of entities that have a huge impact on the global economy and, on the other

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hand, the fate of a large number of the people throughout the world is strongly connected to their activity. It does not make sense whether they are privately or public organized. If the interest in such entities' economic activity is so huge it appears normally the public control should exist. This type of control could result from a bigger independence of the financial external audit. In such a context it is necessary to find the best form of the financial audit upon the financial statements of all such organisms so that to disappear any material interest between those audited and auditors. Actually we mean that as long as one can directly negotiate a price for the audit service the partners could easily become strongly subjective. Where money comes around the objectivity weakens. There have been, unfortunately, too many examples in this way. Therefore our proposal would be an audit which has not to be paid by those audited. Nor has it to be previously ordered by them or even planned. Who would be it exercised by? The answer could be: either a private audit company being paid by the world or European public organisms (G20 Group, European Commission) in case of The World Bank, rating agencies, big insurance groups, Stock Exchanges, and so on, or a supreme audit institution at the level of entities of a country interest.

It would be a big challenge for financial audit to help, in a way, economic system, especially in the crisis period. It is also a good opportunity to take advantages from. In his excellent words the Stanford economist, Paul Romer has so perceptively warned: "A crisis is a terrible thing to waste".

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