PROFESSIONAL JUDGEMENT: A MUST IN THE AUDIT OF FINANCIAL STATEMENTS

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Abstract: *Professional judgement involves the application of auditor's knowledge, skills and experience during all stages of the audit. Our article aims to study professional judgement in the audit of financial statements. It should be applied correctly and consistently in order to obtain a fair view of financial statements and to meet all financial users' need for information. Being a mix of cognitive, technical, theoretical and cultural factors it was and is studied worldwide. The study highlights the fact that audit of financial statements needs professional judgement during all level at the audit. At the beginning the auditors must use it in order to select an audit client and judge the risks associated with it. During the planning stage the financial statements risks must be assessed and the proper level of procedures set for each financial statement line. Professional judgement must be used also during the testing phase when using techniques as sampling, when analysing complex transactions in which substance over form principle should be respected. Last, but not least a correct opinion should be given for the financial statements of each company. All in all, professional judgement becomes a must for auditors in the complex situations met.*

Keywords: professional judgement; audit; financial statements.

JEL classification: M 40, M 42.

1. Introduction

The economy transforms our world, the companies being the engine of this transformation. Today humans live in a globalized economy where information, especially of financial nature is a precious one. The citizen of our century affirms: "Time is money". This citizen is one of the users of financial statements, he can be an analyst, investor, creditor, employee or supplier of economic entities.

This user is interested in the quality of financial statements, seeking an opinion on the accuracy and correctness of economic information.

Financial audit provides users an opinion on the financial statements of the economic entity. To form an opinion, auditors should draw conclusions on the evidence obtained, which should be sufficient and appropriate, in order to provide assurance to users of financial statements that these are not materially misstated. There is always a risk of possible errors or fraud.

Financial audit techniques and procedures are used in order to draw conclusions on the financial statements of viable economic entities. In auditing financial statements, the auditors use sampling methods in order to provide a reasonable opinion that financial statements are free of material misstatements.

Using audit techniques is not sufficient. The auditor must use his professional judgement, the product of his experience and knowledge, in order to draw viable correct conclusions.

Various researchers have questions regarding professional judgement. The issue was debated in Romania and especially abroad, with studies in well developed capital markets.

Carpenter et al (Carpenter et al., 1994) argue that the auditor's judgment is a cognitive, a technical and also a cultural phenomenon. The authors point out that the auditor's judgment has several dimensions. We are talking about a cognitive dimension, which is based on theoretical knowledge acquired during the years of study and specialized courses, on a technical scale solidly endorsed the audits within individual work experience and not least, the a cultural dimension, which is the cultural specificity of each individual.
Xiling Dai (2010) concluded that professional judgement for accountants and auditors means taking into consideration the management and environment business characteristics of the company, in spite of the weaknesses in accounting theory and technology.
According Ferguson's study in 2011, professional judgement requires objectivity and independence, but the study reveals that human beings are naturally inclined to an unconscious bias. This means that auditors must struggle to become independent and sceptical against their own nature, otherwise they risk an inappropriate audit opinion.

2. Case study

The study reveals the fact that the audit of financial statements needs professional judgment, coming up with valid arguments proving this hypothesis.
The main factors influencing professional judgment are technical, cognitive and cultural, listing among them: the precision and confidence of the auditor, experience, communication skills (so-called "soft skills"), ethical behaviour, professional knowledge, independence objectivity and technical skills.
According ISA 200, professional judgement is "the application of relevant training, knowledge and experience, within the context provided by auditing, accounting and ethical standards, in making informed decisions about the courses of action that are appropriate in the circumstances of the audit engagement."
According to the Explanatory Dictionary of the Romanian language, the noun "judgement", from the French term "rationnement" has the following meanings: 1. operation of reason consisting of a chain of judgments, based on which a conclusion is draw; 2. rational argument stating or denying a fact; 3. arguments used by anyone to his point of view.
According to the same dictionary, the adjective "professional" has the following meanings: 1. care related to a profession, in relation to a profession; which is related to a profession; 2. professional secret = information hold thanks to a profession, not entitled to disclose it to anyone; 3. professional education and specialized training for skilled workers 4. professional disease = specific disease caused by a profession or a profession; 5. (adverbial) with a professional habit.
IASB argued in 2005's Framework about the professional judgement dimension in analysing the "substance over form" situations. In these cases auditors must use their professional judgement in distinguishing the accounting form and reality of the transaction, presenting and disclosing the correct economic substance of the matter to users of financial statements.
Professional judgment can be evaluated on the basis that the conclusions reached reflect a competent application of auditing standards and accounting principles, and is appropriate in the light and in accordance with the facts and circumstances which were known by the auditor to date of the auditor's report.
Before giving their consent to provide a service to a new or existing client, an assessment should be made of professional risks involved, so from the beginning the auditor should use their professional judgment. This involves assessing the acceptability of the person or entity as audit client and professional risks associated with the service provided.
For commitments for which certain specific procedures are agreed in advance, this mission involves judgment on the adequacy of procedures to be performed. For example, the client may request the check of all travel expenses, for a longer period, higher than a

certain threshold, comparing them with supporting documents, for the purposes of internal fraud investigations. In this case judgments will not be made about whether testing will performed under a lower threshold of significance, other than that set by the client. Judgment is required, however, to decide whether the audit company may accept such commitments.

The auditor must not accept commitments where auditor's competence has little relevance or if the association with the audit firm could cause the user assigning a higher level of assurance than is justified, such as when the procedures would seem simply to link the prestigious audit firms of certain data, rather than to help assess problems.

In addition, the audit firm should not accept to perform procedures:

• that are subjective and open, thus to different interpretations;
• involving a simple reading of the work of others, only to describe their discoveries;
• constituting an assessment of competence or objectivity of a third party;
• requiring interpretation of documents outside the scope of professional accounting expertise;
• just to get an understanding of a topic.

Accounting rules and auditing regulations are becoming more numerous, and the pressures inside and outside entities may affect the way audit engagements are conducted. It becomes mandatory the judgment's analysis used by auditors also during the audit engagements.

There were situations when companies received a favorable audit opinion, before appearing cases of fraud or collapse to these companies. Examples are cases such as the S & L in the US and the UK BCCI, Enron, and Mirror Group. Issuing a wrong opinion of the financial statements could result in loss of reputation and litigation and financial losses for audit firms.

Another situation in which professional judgment becomes essential, refers to the events after the reporting period of the financial statements. These are events that occurred after the end of the reporting period but before signing the report and events occurring after signing the audit report.

These events sometimes occur after the reporting period of the financial statements, but before the date on which the audit report is issued. They have a significant effect on the financial information therefore require adjustment or disclosure in the report.

Although the auditor has no responsibility to detect subsequent events, he performs inquiries and discussions with the audited company about any subsequent events that could have a material effect on the information, taking into account any other information about future events, which comes into view inside and outside the audited entity. When performing this procedure the auditors request conclusions on subsequent events included in the representation letter.

Examples of subsequent events requiring adjustment of audit report include:

• publication of new information on emission factors for greenhouse gases after the reporting period but before issuing our report;
• work accidents that occurred after the reporting date, but on an incident which occurred before the reporting date (for example, an explosion in a mine in which a number of employees were seriously injured and died later).

There may be subsequent events requiring no adjustment, but require disclosure in the financial statements, for example, a serious spill of hazardous waste at the reporting date, which could call into question the organization's ability to continue to operate.

After the report was issued, the auditor has no obligation to perform additional audit procedures on the information in the report. However, if, after the date the report was issued, the auditor becomes aware of circumstances which, had it been known at the time the report would have caused its modification must:

- discuss the matter with management of the audited entity and, where appropriate, those charged with governance;

- determine whether the audit report needs modifications, and if so, ask management about how they intend to address this subsequent event.

If management agrees with changing the report, the auditors, using professional judgement, proceed with the audit procedures necessary in those circumstances, review the measures taken by management to ensure that any user is informed of the situation and gets the correct report.

3. Conclusion

In the century of speed, users of financial statements should be correctly and timely informed about the financial position and results of the entity, in order to make correct investment decisions.

In all stages of the audit professional judgement must be used to assess acceptance of a new or existing client, to test financial population of data, to draw a correct audit opinion and to perform subsequent events procedures.

Professional judgement becomes mandatory, in order to give a reasonable assurance that the financial statements present a fair view and do not contain material misstatements.

Acknowledgements

This work was co-financed from the European Social Fund through Sectoral Operational Programme Human Resources Development 2007-2013, project number POSDRU/159/1.5/S/134197 „Performance and excellence in doctoral and postdoctoral research in Romanian economics science domain".

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