

„ALEXANDRU IOAN CUZA” UNIVERSITY, IAȘI
FACULTY OF ECONOMICS AND BUSINESS ADMINISTRATION
DOCTORAL SCHOOL OF ECONOMICS AND BUSINESS ADMINISTRATION

DOCTORAL THESIS
VALIDATING THE FINANCIAL REPORTING
THROUGH THE EXTERNAL AUDIT
SUMMARY

SCIENTIFIC COORDINATOR:

Professor PhD EMIL HOROMNEA

PhD candidate:

TANASĂ E. FLORENTIN-EMIL

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Introduction

The performance criterion of accounting is the “*exact representation*”, the measure in which it displays reality, through complete and reasonable information on the transactions and economical events. The quality of the decisional process, as well as the efficiency of the capital markets and of the national economies are directly linked and also by the quality of the accounting reporting, of the normative and regulatory system. We note the fact that the lack of some precise provisions or their ambiguity determined sounding failures of some big corporations¹. By financial engineering, error and fraud, they proceeded to a deliberate distortion of reality regarding their performance and position on the market. Directly or indirectly, the users’ perception was manipulated and especially that of the investors.

Under these circumstances, the examination and certification of the financial situations by a competent and independent person constitutes an essential process for the credibility of businesses, which contributes implicitly to the diminishing of the risk assumed by the present and potential investors. Through the expressed opinion, the auditors validate if the information in the documents of synthesis present a *faithful image* of the transactions and operations unfolded by the entity and if they were completed in conformity with a general, applicable reporting framework.

We state that in our approach, the concepts of *financial audit* and *statutory audit* are equivalent. According to the Community legislation (Directive 2014/56/EU of the European Parliament and of the Council) and of the national regulations (Emergency Governmental Ordinance 90/2008), the statutory audit represents the mission achieved in conformity with the International Audit Standards, respectively the audit on the *annual financial situations and the consolidated financial situations*.

We think that through our endeavour, we contribute to obtaining some clarifications on the connections between the financial reporting, performance, risk and financial audit.

Motivation and the importance of research

In the current economical context, the financial information has become the fundamental element for taking strategic decisions by the corporations, but also for any investor or creditor. The big challenge for the management of any entity is to hold relevant information at the right moment for the purpose of obtaining a competitive advantage.

¹ Here we mention only some of these. Globally: British South Sea, Banque Generale Privée, Enron, Arthur Andersen (audit company, of fiscal consultancy and accounting), Parmalat, Worldcom, Barings, Merrill Lynch, Satyam, Madoff, Tesco, LIBOR, Dynegy. In Romania: FNI and SAFI (investment funds), Hidroelectrică, Oltchim.

The process of normalization and the mode of presentation of the financial situations constantly evolve, as a result of the increase of the users' necessities of information. On the basis of the financial analysis and of the data obtained from the stock exchange markets, the investors base their to-be-adopted decisions on being able to elaborate prognosis with regard to the future results of the enterprise. Through the used methods and techniques, the financial analysis contributes to the knowledge of the state of different phenomena, identifying the factors and causes that generate it, as well as taking the proper measures for making the results more efficient.

In an ever more abstract² economy, dematerialized, the opportunities to deliberately distort the reality of transactions and the operations undergone by the companies and implicitly to commit financial frauds are all the more numerous. The challenges of the process of globalisation, the “dramatic” progress of the informational technologies, besides ever present in the processes with economical nature, impose new techniques and auditing mechanisms of the accounting reporting, respectively of the financial position, of the performance and treasury flows. The attempt is made by a professional accountant. For obtaining reasonable securities as concerns the extent to which the financial situations as a whole does not contain significant distortions, the financial auditor has to be accustomed with the auditing standards of the informational systems, with the interrogation techniques of the databases or with the notions specific to statistics and from the area of the commercial law.

The methodology of research. Approaches and used methods

In our research, we tackled both elements specific to the quality approach, as well as to the methods of the quantity approach. The methodology of research presents the stages completed for reaching the goal and the aimed objectives. Throughout the chapters and the subchapters of the thesis “*Validating the financial reporting through external audit*”, for substantiating the theoretical and applied aspects, we resorted to a series of working instruments circumscribed both to the quality approach, as well as to the quantity one: revising the specialty literature, the method of correlation, the analysis of the main components, the mathematical-statistical methods, the phenomenological interpretation, the study of documents, the bibliographic investigation, case studies. Moreover, for obtaining

² We mainly refer to the exponential growth of the derived financial instruments – futures contracts, forwards, options, swaps. In December 2014, this market was evaluated at approximately 630,000 milliards USD. (<http://www.bis.org/statistics/dt1920a.pdf>, <http://www.bis.org/ifc/publ/ifcb35a.pdf>, accessed on February 2015)

results and increasing their credibility, we resorted to methods of the financial analysis and of statistics. With the help of the statistical software SPSS 13.0, we used methods of the descriptive statistics, the Pearson correlation indicator and the analysis of the main components (ACP). Also, for outlining some information and presenting the results in a synthesized form and easy to understand, we used charts and tables. The scientific elaboration qualifies into the scope of the following fields: financial audit, economical-financial analysis, financial reporting.

This paper takes on an applied character. The validation of the working hypothesis is achieved through a deductive-inductive process that presupposes a theoretical approach through which the specific notional landmarks of the studied issue are integrated and an applied approach, using the methods and interpretation techniques of the data specific to the economical-financial analysis and statistics.

Final conclusions, personal contributions and future research directions

The recent global crisis brought a change in the way in which the world sees the capital markets. Certainly, *the auditor is part of this process of redefining the macro-economical balances. He offers credibility to the financial reporting and the accounting information.* In a certain sense, besides the traditional roles, he has to assume a new responsibility, that of taking part in the reconfiguration of the financial system.

Through the work “Validating the financial reporting through external audit”, we aimed at reaching the following fundamental objectives:

- developing a theoretical debate around the role taken on by the financial audit in the process of credibility for the financial reporting;
- presenting and using some models of estimate and evaluation of the audit risks;
- selecting and presenting some instruments of financial analysis that can be used as analytical procedures within audit missions;
- opening some new directions of research nationally by using “*the theory of games*” and of “*the Nash balances*” in audit.

With the purpose of reaching the aimed objectives, the scientific attempt was organized on two representative levels. The quality research was used mainly throughout the chapters I and II, being dedicated to the analysis of the specialty literature and the theoretical substantiating of the notional landmarks specific to the investigated field. This way there were highlighted elements such as: recent evolutions in financial reporting; new powers of the

concept of performance; responsibilities of the professional accountant; possibilities, limits and challenges in the capitalization of the financial information; landmark moments and regulations in the profession of financial auditing, perceptions and expectations of the users by financial reporting as compared to the financial audit in Romania.

The chapters III, IV, V include the applied part, empirical and of the case studies. It presupposes a quantity research, extremely useful in quantifying the results and validating the working hypothesis. This section of the thesis is made up of an empirical study that describes the connection auditor-client entity through the theory of games and the Nash balance; the case studies through which the audit risk is evaluated through the method offered by the standards, through the Bayesian inference model and through the method of the trusting functions; a study through which the identification and presentation of some representative indicators of financial and stocking exchange order for the evaluation of the companies and an analysis of the performance of companies listed at BVB through the DuPont instalment system.

Chapter I, entitled “Financial-accounting reporting of the enterprise. Conceptual delimitations and theoretical foundations” qualifies as a quality research. The first part adds up in an analysis of recent evolutions in the financial reporting and of the role of the profession in obtaining some reliable information. The controversies regarding the structure of reporting documents and new valences of the concept of financial performances are of the elements presented throughout this chapter. Also, an analysis is made of the quality characteristics of the financial information in the context of the responsibility of the leadership for the assessment of the entity’s capacity to continue its activity. Last but not least, some limits and challenges are identified in the capitalization of the financial information.

Chapter II, “Landmark moments, regulations and connections in the evolution of the financial audit”

In the introductory part, it is reviewed a series of historical landmarks concerning the evolution of the activity of financial audit, worldly and nationally. The role of the audit, the objectives and responsibilities of the auditor are other inserted elements of interest. A special attention was granted to the implications of the current economical context over the activity of the professional accountants and the process of adopting IASs. For establishing a reasonable trust between producers and users of the financial-accounting information, it is necessary that the function of internal control, internal audit and external audit to be assessed as an

integrated system. Also, there are analysed the modalities through which the accountant professionals, especially auditors can add value to the companies.

In the final part, it is presented a study regarding the perceptions and expectations of the users of financial reporting as opposed to the activity of financial audit in Romania. Through our research, we aim at contributing to the specialty literature in Romania through assessing the “audit expectation gap” (AEG) at the level of users of financial reporting and presenting some possible solutions for its diminishing.

Chapter III, “The economical-financial performance of the companies listed at the Bucharest Stock Exchange (BVB)”

Throughout this chapter, there are two studies presented, regarding the economical-financial and stocking exchange performance of the companies listed at BVB. Each research includes elements, such as: the study of knowledge, the methodology of research, the used methods and techniques and the obtained results.

Within the first study, the purpose was the presentation of some representative indicators for the evaluation of performance and risks of the non-financial companies listed at BVB. The analysed period is that associated with the financial exercises 2006-2014. The first analysed year is 2006, because through the adopting of the OMPF 1752/2005, all the companies apply the same rules, respectively the accounting regulations according to the European directives. Thus, it is ensured the capacity of comparison for the data used in the analysis. The target population is represented by the companies listed on the regulated market of BVB. The analysed sample contains a number of 57 non-financial companies listed without interruption during 2006-2014.

Our research took into account the elimination of the redundant information and constructing some main components of the financial situations that can facilitate the assessment of the listed companies, function of the objectives of each current or potential investor.

In the second study, it was analysed the performance of the companies listed at the Bucharest Stock Exchange (BVB) through the profitability instalments of assets (ROA) and of their own capitals (ROE) with the help of the managerial leverages in the DuPont system. Through the ROA and ROE decomposition in margin instalments, of rotation and structure of capitals, it was aimed at identifying the weak and strong points of the economical-financial performance and the analysis of the modalities to improve it.

Chapter IV, "Assessment and analysis of the risks in the financial audit"

The chapter begins with presenting some theoretical and methodological aspects regarding the audit risks. In the specialty literature, among the most well-known models of determining the audit risk, there are: the analysis of the risk factors, the quality approach of the risk, the fuzzy theory, the Bayesian model or the pattern of trusting functions.

The applied part includes several case studies. Within them, it was proceeded with the assessment of the audit risk through the method offered by standards, through the Bayesian inference model and through the method of trusting functions. The company considered in the case studies is Alumil SA. Regardless of the used method, the auditor has to offer a reasonable level of security that the formulated opinion is correct.

In the last part of the chapter, there are presented a series of risk factors of the auditor, phase-structured on the mission (accepting the client, planning the audit, assessing the internal control, the control of the accounts).

In *Chapter V*, entitled "*Shaping the auditor-client entity relationship through the use of the theory of games and of the Nash balances. Empirical study*", we proceeded to the shaping of the auditor-client entity relation through the use of the theory of games and of Nash balances.

The auditing process of the financial situations was analysed through the respect of the strategies adopted by the auditor and the client entity. Possible types of decisions were identified with the help of the Nash *balance* concept. The central objective of the research was represented by the identification of the factors that influence the degree of utility on the one hand of the services performed by an auditor, and on the other hand, of the information contained in the financial situations issued by the client company. The present-to-day quality of the addressed topic results from the necessity of ensuring an effective communication to the interested parties and of studying the effects of a reporting that does not offer a faithful image. For reaching the objectives of the research, the paper used a survey-like questionnaire.

For using the Nash balance model, we consider that in one fifth of the cases, the enterprises prepared financial situations that do not present overall a correct image on the transactions and unfolded operations. Such a situation is in line with the average number of audit reports between 2011-2014, for the companies listed at BVB, expressing reserved opinions or even contrary opinions.

Finally, we are convinced that there are other areas related to those studies that can spark the interest of theoreticians and practitioners in the field. Therefore, we think that the

theoretical foundation of the analysed problems, as well as their applied approach, sometimes even empirical, remains open to some future concerns.

Following the research of the doctoral studies' theme, we recount in brief the main *personal contributions*, both in theory, as well as in the applied plane. Of these we mention:

- outlining the role of the accounting profession in obtaining some relevant and credible information for taking decisions by the management;
- presenting some new valences of the performance concept in business;
- presenting some limits and challenges in capitalizing the information in the financial situations;
- suggesting some solutions for minimizing the gap of perception between the audit role and the manner in which it is perceived by the users of financial reporting (*audit expectation gap*);
- identifying some representative indicators of financial and stocking exchange order, based on which pertinent decision can be taken regarding the performance and risks of the companies listed at BVB;
- identifying the performance leverages in the DuPont system used by the companies listed at the Bucharest Stock Exchange (BVB);
- assessing and analyzing the risk of audit through the method offered by standards, through the Bayesian inference model and through the method of the trusting functions;
- presenting the main risk factors of the auditor in the phases of the mission.
- opening some new trends of research nationally by using “*the theory of games*” and of “*the Nash balances*” in audit.
- identifying the model of “*theoretical game*” and of the balance model in “*the theory of games*” that offers the best relevancy of results.
- identifying the factors that influence the degree of utility on the one hand of the services performed by financial auditors, and on the other hand of the client entity;

The doctoral thesis “*Validating the financial reporting through the external audit*” also presents a series of *limits of research*. A first limit refers to the contained number of reference sources analysed, due to the fact that there are other dimensions of the field as well, which were not included in our approach. The main limit refers to the possibility of extending the results obtained within the empirical study. The relative reduced number of filled-in questionnaires did not allow us to extrapolate the outcomes regionally or internationally.

We think that these limits do not have a significant effect on the unfolded research and do not affect the relevancy of the formulated conclusions.

As concerns *the future research trends*, we aim at deepening the studied matter, eliminating the identified limits and improving the working method. For the future, we plan to accomplish a method of shaping the audit risk by using “*the theory of games*”.

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