

EUROPEAN STANDARDIZATION OF AUDIT

OANA RALUCA IVAN *

ABSTRACT: *The article reviews the evolution of external audit in some European countries and considers how this is likely to affect auditing in the future. The analysis shows how the European Commission has recently concentrated its harmonization focus on the consolidated accounts of listed companies and the use of International Accounting Standards. It is probable that this trend will continue and in the short term will cause changes in the arrangements for external overview of the audit and in national auditor rules.*

KEY WORDS: *EU, external auditing, IASs, audit mandate*
Jel: M42, N40

1. INTRODUCTION

The utility of a scientific research resides in the necessity of giving answers to some current, very concrete, questions that may contribute to a better understanding of the phenomenon. The present paper, proposes itself to demarcate the most important concepts in the field of financial audit, contributing to the organic and functional analysis of the auditing process with its most significant elements, techniques and work tools. At the beginning of this research materialized in this study, the knowledge of different types of research allowed us to approach both the theoretical and methodological aspects in the most suitable manner. We have used mostly *a descriptive type of research*, objectively portraying the social phenomena in the attempt of formulating some hypotheses, or in judging the existing ones as suitable or not suitable for a certain social context. As for the practical study we have chosen an explicative type of research, having as a purpose the putting to value of the relationships between the phenomena: the way certain parameters (e.g. turnover, total assets, the number of employees), influences the auditor mandate. In the explicative part we notice the appearance of the possibility of making predictions.

In the whole extent of the study we did not use the application of the two approaches as extreme typologies of a sociologic research; in fact we might say that

* *Assist.Prof., Ph.D., "1 Decembrie 1918" University of Alba Iulia, Romania,*
ivanralu@yahoo.com

both parts of the research contain, to a certain extent, descriptive elements. The explicative part contains a description of the situation while the descriptive part withholds explicative elements through the classification it introduces. For the first part we consider that the research has a descriptive tone, with an evident qualitative character, but still holding quantitative elements, while in the last chapter the research is clearly explicative and with a strong quantitative character but holding qualitative elements. Kuhn's [4] series of paradigms (1970, 85) regarding the differences between the qualitative and quantitative types of research can be easily approached permitting to underline the difficulties in the strictly delimiting of the research periods: *the qualitative research is subjective while the quantitative one is objective; the qualitative approach attempts a detailed description, while the quantitative approach searches for laws that could explain the phenomenon; the qualitative study is an exploration of that which seems to be a dynamic reality, while the quantitative study, that what seems to be a statistical reality in the purpose of developing universal laws.*

In this final moment of the scientific road we have undertaken for the present paper we cannot afford to give a generally valid classification to the type of research we used, because we are unable to portray a unique characterization. And it seems that this is not a dilemma that concerns only our research. The nowadays problem is that many authors face the same difficulty in circumscribing their works to a single well determined method of research, most of the recent literature in the field allowing and even promoting an interdependence of the different types of research, shifting and mixing in accordance with the needs required by the element taken under observation.

In the context of overall scientific knowledge, accounting, and by this implicitly the audit, together with the finances finds itself included in the sphere of administrative sciences. It is considered to be the most exact of all the social sciences. Its collocation derives both from the practical role accounting, audit have and from the ways of tackling with the audit problems of the great American business schools (e.g. Stanford, Harvard, Massachusetts Institute of Technologies, Cornell, Wharton) and of some of the countries of Western Europe, especially France, The United Kingdom, Germany. The above mentioned motivate the opinion according to which the *relationship between accounting, audit, finances and psychology is implicit* because they all find their object of research in the study of the human behaviour. The investigation of the psychological variables in the financial – accounting domain highlights a certain attention to the analysis of each component that might create the possibility of obtaining a clear and correct image of a determined studied field. The present scientific investigation modestly subscribes to the attempts for formulating conclusions: first of all, to the auditors' mandate and their attitude in respecting the standards, by studying an audit quality report.

2. AUDIT – EMERGENCE, EVOLUTION AND NEED

Firstly we attempt to outline objectively the social phenomena which brought about the advent of the financial audit phenomenon and, given the circumstances, the methodology of study employed by me is specific to descriptive research with elements of explanatory research by delineating some new classifications. Concerning *the*

evolution in time of the audit process I thought it would be appropriate to make a demarcation on three time segments.

The first segment covers the period from *The Ancient Times up to the 18th century*. We may say that during this time range, there were only incipient forms of financial audit as it was not delimited yet from the accounting and control activities and the individual carrying out this activity would be generically called the accountant. The works required were mainly meant to prevent frauds or to discover these frauds and punish the thieves. The main beneficiaries of these works were various kings and emperors, the church and the state, and the accountants had a certain social status in that respective epoch as they generally were priests or specialists in the field who were acknowledged as having high moral standards.

The second time segment is the period ranging in between *1850-1900* when *the first forms of audit emerged as a professional activity*. The practice of audit itself dates back to more than one thousand years ago but it is only in the second half of the 19th century that trading companies would *check their accounts* by resorting to the help of accounting experts *from outside* the company. In America, the first signs of accountancy conceptualization appear after 1887 when the American Institute of Chartered Accounting Experts is set up. As compared to the previous period of time, we can state the change of the group of users of the results brought about by the financial audit activity, as they were, in the 18th century, the state, the shareholders and the banks. These would require the best accountants of the time to make audit works that would provide the best solutions for safeguarding the integrity of patrimony and provide the public with the most accurate form of financial statements and activity results. By the end of the 19th century, the profession of financial auditor already begins to take shape and the group of users of audit works are still the same: the state, the banks and the shareholders whose main purpose was to prevent frauds and mistakes, to certify the observance of accounting rules as well as to have a financial audit report outlining the degree of compliance with the true image of patrimony // assets. In conclusion, financial audit was known as a distinct specialization of accountancy about the 19th century though we do not know a precise date or place.

The third segment covers the time range between *1900 - to the current day*. In the period 1900-1920, the profession of auditor sets apart from that of accountant. In the United States of America, there emerges a nucleus of the profession of financial auditor as a liberal profession which becomes an opinion leader by setting up, in 1905, a special department within AICPA (American Institute of Certified Public Accountants). In the USA there emerges also the need to establish some audit practices specific to the American economy as taking over *ad literam* the British audit practices no longer match the specific of business in the USA [5]. Therefore, the first attempts of conceptualization emerge by means of the first recommendations concerning audit missions: in 1910, the first manual of audit was published [2] and in 1917 a professional guidebook was issued in which it was clearly depicted what economic grounds an audit mission [1] was supposed to cover. The time-line determination in the evolution of the profession of auditor as a liberal one, does not exclude, in fact it requires a demarcation on levels of development/initiation of *de facto* objectives of audit. This demarcation of the evolution of the liberal profession of an auditor by tracing it back in the course of

time does not exclude but it even requires a demarcation by levels of development / initiation of the *de facto* objectives of audit. Similarly to the worldwide context, the audit activities in Romania have emerged and evolved in harmony with the record-keeping, accounting and control activities. From the study of bibliographical resources we notice that the informational sources concerning the evolution of financial audit in Romania specify mainly aspects concerning the public sector. In fact we were able to find little reference to the private sector.

The time range 1831-1858 is marked by the emergence of financial control, in a period of time when there was still confusion between the revenues and the expenses of the country and *the budget* of the ruler as there was not an evolved form of state control. In the Romanian Principalities, *The Organic Rules and Regulations* - of Muntenia and Moldavia - were issued, comprising some incipient forms of organization of public finances. The modernization of public finances as well as that of the financial control occurred after the administrative Union of the two principalities, especially after the ruler of the principalities Alexandru Ioan Cuza promulgated the Law on Setting Up the High Court of Accounts on January 24th 1864.

In the inter-war period, the law of 1929 on Public Accounting introduces the double entry bookkeeping system as a type of bookkeeping which is used to the present day. From now on, accounting records, the statements and the accounts concerning budget operation and public money handling make possible the control and the knowledge of the financial state of the country. The political evolution taking place in our country in *the post-war period (1945-1989)* had a great impact on public finances especially in what the financial control is regarded, in the sense that institutions of a deep democratic nature were dissolved and replaced with institutions subservient to state-control dictatorial policy. These regulations concerning the organization and the execution of preventive control in institutions, enterprises and state-owned economic organizations were approved in 1959 and the head of the accounting-financial department is assigned the preventive control of the unit.

After 1990, *the contemporary period* of financial audit organization emerges. Romania, passing to an economy based on the concept of competition, returned, implicitly, as far as the public sector is concerned, to the former financial institutions of the inter-war period, adapted to the actual conditions of transition period for the public sector. At the same time, in the private sector, professional bodies come into being. Though financial audit existed in the Anglo-Saxon and French - speaking countries in the European area, being subject to a permanent improvement for almost four decades, in Romania, it emerged only after 1990, as a necessity for further specialisation in the field of accountancy. Year 1993 marks, in our country, the advent of financial audit offices and in 2004 there were already 477 financial audit offices registered with the Chamber of Financial Auditors of Romania. The year 1993 marks, in our country, the advent of financial audit offices and in 2004 there were already 477 financial audit offices registered with the Chamber of Financial Auditors of Romania. The body regulating this profession in our country, the Chamber of Financial Auditors of Romania was set up in 2000 and its mission was to build, on a solid base, the identity and the public recognition of the profession of financial auditor in Romania having as a main purpose the constant development of this profession and to strengthen it by

means of Audit Standards and the Code of Ethical and Professional Conduct in the field of financial audit, through the complete assimilation of the International Standards and of the IFAC (International Federation of Accountants) Code of Ethics in order to allow the financial auditors, members of CAFR (Chamber of Financial Auditors of Romania), to supply high quality services of financial audit, serving the interests of the public, in general, and that of the community, in particular.

3. AUDITING IN EUROPEAN UNION

We consider that in order to serve the public interest, IFAC takes actions in order to consolidate the position of the profession of accountant at a world level and contributes to the development of some strong economies by establishing and promoting the acceptance of high quality professional standards aiming at the international convergence of such standards, taking public positions in the issues in which the state or the importance of the liberal accounting profession is the most relevant. *In conclusion*, the International Standards of Financial Audit can be applied in several ways: by their use in the original form, being turned into national standards; as a source of national standards of financial audit or as a reference system for the harmonization of national regulations with the community acquis.

Within the *European Union*, legal audit has been approached in the course of time in four Directives of the European Community: the Fourth Directive 78/660, of 25th July 1983 (modified by Directive 90/64 and 90/605 of 8 november 1990); the Seventh Directive 83/349 of 13th June 1983 (modified by Directive 90/64 and 90/605 of 8 november 1990); Directive no. 86/635 of 8th December 1986 annual accounts and consolidated accounts of banks and other financial institutions; the Eighth Directive 84/253 of 10th April 1984 (modified in 2005). The Fourth Directive (Fourth Directive, art.51, alin.1, a) lays down explicitly which economic entities must audit their financial statements for each country which is member of the European Union, this obligation extended automatically over the entities having the same consolidated accounts (Seventh Directive, art. 37).

Concerning *the field of application of compulsory financial audit* (or legal) we could note an explicit (negativist) delimitation with the following common elements for each country member of the European Union: Total balance – varies from 1.55 million euros in France - 3.65 millions euros in Holland (in absolute minimal values); Turnover - varies from 1.5 millions in Ireland to 6,875 million euros in Germany (in absolute minimal values); *Number of employees* - 50 employees for any country of the European Union less Sweden - 200 employees, as in table 1.

Concerning *the main features of the mandate of auditors* as compared to the level of some states of the European Union, these are outlined in table 2.

4. AUDITING IN ROMANIA

The ideological delineations from the field of auditing in Romania greatly absorb the contemporary international general conceptual frame. The *ad-literam* assumption of the General Frame, of the Ethical Code, of the International Audit

Standards, by the Romanian legal system, determined an approach with a high degree of uniformity with respect to the ongoing research at a national level from the part of the researcher.

Table 1. Financial audit within European Union

The exception required by law for financial audit *	Total Assets	Turnover	No of employees **
The Fourth Directive of EU	3,125	6,25	50
Germany ***	3,438	6,875	50
Belgium	3,125	6,25	50
Spain	2,37	4,75	50
France	1,55	3,10	50
Irlande ****	1,90	1,5	50
The Netherlands	3,65	7,7	50
Great Britain	2,8	5,6	50
Sweden			200

* Amounts in milions euros for EU countries and in milion pound for Great Britain; ** The average number of employees during the financial exercise; *** Only to capital companies; **** Exemptions introduced only in 1999.

Table 2. Main features of auditors' mandate in UE

Country	Nomina- lization	No of auditors	The period of the mandate *	The possibility of revocation	Renewal of contract	Deputy auditor	Fee
France	SGA**	1 or 2	6	Yes, by court	Yes	Yes	Limitless , Not public
Germany	SGA	1	1	Yes, but through Justice means	Yes ***	Unforeseen explicit but possibly	Limitless , Not public
Belgium	SGA	1	3	Yes, with SGA compliance, for just motivations	Yes	Unforeseen explicit but possibly	Set by SAG, mentioned in the sessions minutes
Spain	SGA	1	Variable (3 to 9 years)	Yes, with SGA compliance, for just motivations, and with Court of Laws' accord	Yes, but at least 3 years have to past after the end of the previous mandate	Yes, for individual auditors	Set by SAG, published in Commerce Register
Irlande	SGA	1	1		Yes	Unforeseen explicit but possibly	Mentioned in the Financial Statements, approved by SAG
The Netherlands	SGA	1	Undeterm- ed	Yes, with SGA accord	Yes	Unforeseen explicit but possibly	Limitless
Marea Britanie	SGA	1	1		Yes	Unforeseen explicit but possibly	Mentioned in the financial Statements
Suedia	SGA	One or more	Precised in the statuf of compay	Yes	Yes	Unforeseen explicit but possibly	

* numbered in financial exercises; ** SGA-Shareholders' General Assembly; *** To anonymous companies listed to Stock Exchange the Commerce Code precise a rotation of Wirtschaftsprufer - signatory auditor within the audit company.

A society having an audit culture represents a real challenge for the scholar intending to underline the most important steps in the evolution of the auditing process, as well as its determinant factors, in a study of strong documentary character. As we have previously suggested, this is not the case of Romania.

According to the Last Report concerning the activity carried out in 2006 by the Monitoring and Professional Competence Department within CAFR concerning the activity of Audit Planning, the attention is drawn to some specific tests and objectives which were documented and carried out by the auditors involved in the review in a non-satisfying ratio. The analysis of the data within the Report concerning the activity carried out in 2006 by the Monitoring and Professional Competence Department within CAFR, respectively the statistical data of the accomplished quality audit is outlined in the table below for the auditing activity (table 3).

The situation of quality audit at the closing of closing of auditing process is *the best* of the three stages of the process. The problems encountered by auditors – natural persons who failed to comply, in their work, with the objectives concerning the principle of activity continuity but in a ratio of 48%, a lower percentage that the one obtained in the quality audit of planning activity for the same parameter (54%). This also indicates that the discussions with the management of the entity audited and performance of adjustments are deficient.

We can express our opinion that in the current situation, the percentage to follow up audit standards is so low as the problems raised by any possible adjustments represent an aspect of strong conflict between the entity's management and the auditor. Therefore, not even objective 31, *Comparison of the amount of differences non-adjusted with the significance threshold* cannot present a better percentage of accomplishment as the previous failure to perform the adjustments brought about, absolutely logically, to the impossibility to compare them with the significance threshold. The auditor - as individual tries to comply with the structure of working sheets, but even the compliance from the form point of view exists only in a percentage of 42% of cases. We can note instead a greater compliance, yet non-satisfactory for the auditors - legal persons (56%). The participation in the inventorying process is an objective which is reached in 67% of cases for natural persons and 72% for legal persons as this objective is best accomplished.

Taking into consideration the importance given to the inventory of reference books in the special literature and the analytical curricula of the universities in this special field is one of the relevant factors in obtaining this percentage. The verification of the depreciation method and the calculation of depreciation is also one of the five objectives with the *passing note* accomplished by the auditors' natural persons. The percentage of more than 50% obtained in 2006 for the objectives: contracts with banks and the contracts of leasing can be justified, *in the opinion of the author*, by their high standardization degree which facilitates the examination of the data to be checked.

This report indicates *three major deficiencies of the auditing activity* in Romania: a little assumption of the new, by failing to check the existence of the affiliated parties both of natural persons (21%), and legal persons (35%); little interest in checking the net achievable value; verification to a less extent than the significant

sampling threshold of the useful life time according to IAS 16, respectively 18% - legal persons and 14% natural persons.

Table 3. Report concerning the activity carried out in 2006 by the Monitoring and Professional Competence Department within CAFR

No.	Objective name	Percentage (%)	
		Legal persons	Natural persons
AUDITING ACTIVITY			
11	Existence and filling in entirely the sections in the Minimum Auditing Standards	60%	42%
12	Existence of main tables and of work sheets for all of the sections and the verification of their compliance with the accounts	56%	35%
13	Existence of a reference system	67%	42%
14	Verification of mathematical calculations and the existence of a checking system	56%	44%
15	Compliance with the structure of sheet work (objective,, activity carried out, result, conclusion, name of client, related period, reference, date and signature)	69%	50%
16	Existence of confirmation letters from debtors, creditors, banks	72%	48%
17	Existence of confirmation letters from the attorney-at-law / legal advisors	65%	46%
18	Verification of existence of transactions with the affiliated parties (ISA 550, O 22-26)	35%	21%
19	Compliance with the principle of separation of financial exercises	53%	38%
20	Participation in the inventory/ existence of the file and the inventory report, contrary, the expression of an adequate opinion in the audit report	72%	67%
21	Testing the net achievable value (AS 2)	35%	37%
22	Reconciliation with the registers of sales and purchases with the VAT discounts	75%	49%
23	Verification of the consistency of the depreciation method used and the calculation of depreciation for a sample of fixed assets	68%	52%
24	Determination of useful lifetime according to IAS 16	18%	14%
25	Write-down provisions and provisions for risks and expenses presentation and determination mode	62%	49%
26	Long-term loan contracts with banks – presentation and degree of compliance with contract clauses (K point 6)	65%	55%
27	Contracts of leasing – presentation and correct registration	63%	65%
28	Comparison between a sample of invoice of purchase / sale and sale/purchase journal and the Ledger Register (O point 3 of point 12)	61%	46%

www.caf.ro/servlet/DownloadForm?file=rap_Mon_2006.pdf, 20 September 2008;

5. SUMMARY AND CONCLUSIONS

As far as the conclusions regarding the evolution in time of the audit phenomenon we can make a demarcation on three large segments of time:

1. *Ancient Times to the 18th century*, we may conclude that: there were only *incipient forms of financial audit* as it was not clearly delimited from the activities of accounting and control and the works required aimed to prevent and discover frauds and punish the thieves. *The individual* conducting the work was generally called the accountant. Accountants enjoyed a certain social status in that respective epoch; they would usually be priests or specialists in this field whose moral standards were generally acknowledged. *The main beneficiaries* of these works would be various kings and emperors, the church and the state.

2. *The second time segment* we identified is 1850-1900, *when the first forms of audit emerge as a professional activity*. The emergence of audit overlaps in the course of time and at this moment the need arose to separate the competences and the responsibilities of unit heads (*the managers*) from those of the owners. *The individual* performing the audit, respectively *controlling the accounts* is a *chartered accountant not working within the company*. *The beneficiaries* – there's a change in the group of users as they are now the state, the shareholders and the banks. *The Objective* – audit emerges with the purpose to avoid frauds and mistakes, to certify the observance of accounting rules as well as to have a financial audit report specifying the degree of compliance with the faithful image of the patrimony. Financial audit came to be known as a *distinct specialization* of accountancy about the 18th century, though a precise date and place is yet unknown.

3. The third segment starts from 1900 - *to the present day*, 1900-1920 *separation of the profession of auditor from that of accountant*. In the United States of America, there emerges a nucleus of the profession of financial auditor as a liberal profession which becomes an opinion leader by the setting up, in 1905, of a special department within the AICPA (American Institute of Certified Public Accountants). *The individual* performing the audit is an *external auditor*; *The beneficiaries* – the group of users changed; as they are now: the state, the shareholders or the banks and a new category emerges: the user of information with sound knowledge in the field and with no financial interest. *The Objective* – This is how the first attempts of conceptualization emerge: by the advent of the first recommendations concerning audit missions: 1910 – the first audit manual was published [2]; 1917 – the issuance of a professional guide specifying what an audit mission had to cover [1]. Concerning the Romanian economic area we may conclude that for the first time segment we have several elements we can identify which are common to the trends at the world level; as far as the second large time segment is concerned, we could notice a major delay in the evolution of accountancy and in relation to the audit phenomenon, we cannot point out common aspects but after 1990.

As a result of the study of auditing in EU countries, we can conclude that auditors' mandate varies from one country to another despite the constant attempts for harmonization at the level of the European Union. We want to underline that the only exiting uniformity relating the appointment of auditors by the General Assembly of the

entity, which is also the least harmonized segment. The activity of financial audit in Romania went through a period of development as it was normalized and standardized by taking over *ad literam* the international standards in the field, and the extent to which it complies with the European standards is very high as this profession is put in line with the international rules and regulations.

We consider the possibility of identifying two great directions of research in this area: a retrospective one and a prospective one. The retrospective direction of research, represents a study outlining the interrelation and the interdependence of the evolution of financial audit and financial control in the Romanian area, with their evolution in the European area in the period 1750-1900. The prospective direction of research refers to the making of a study pointing out the interdependencies within the European Union in establishing quality factors that influence the mode to appoint and to perform the mandate of a financial auditor. As a result of the study performed, I think that the directions of research which can be outlined are: one of a prospective nature, as a possible direction of study and the second one, as a possible way to improve the auditing activity of financial statements. The first proposal of the direction of research which is *prospective* refers to the carrying out a study outlining the motivations, on the one hand the interdependencies between the auditors supplying also related services to an entity and the degree of independence during the financial auditing process according to a number of quality factors influencing the way to carry out the mandate of a financial auditor.

The second direction of research which is also *prospective* relates to the possibility to carry out a study concerning the civil, criminal and professional liability of the Romanian auditor and its evolution in the Romanian area, in interdependency with civil liabilities, respectively the criminal liabilities of the other categories of free lancers in Romania.

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