

# The Future of Statutory Audit

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## **Abstract**

Lately, more and more analysts have remarked different activities susceptible to fraud or/and complicity between the boards of certain big companies and accountants/ auditors, which ended up with handing in untrue financial statements, the main indicators being mystified and rendering unreal images. It is obvious that the authorities in real estates have mainly adopted solutions that aimed at ignoring the procedure in accordance with which the same company should not offer both accounting services and audit services, or sometimes even fiscal consulting to the same client. Thus, statutory audit has acquired more importance, and the regulation has become more stretched and was included in the legislation related to trading companies and special legislation: real estates, banking sector, insurances and re-insurances, criteria for great tax payers.

The statutory audit performed only by financial auditors was accepted by the E.U. under surveillance through E.C. Directive 3/2006, which required for a new additional legislation with supplementary requirements regarding the job itself. In the last year, people have discussed about a new Directive or even Regulation that is meant to adjust strongly the statutory audit to a dangerous component for a liberal profession, namely the involvement of the state bodies in the job description related to financial auditor. Such an intention is a sort of nationalization of this profession, a return in time and the waiving of all the achievements of the profession. In this context, it is natural to think of the future of statutory audit.

**Keywords:** statutory and financial audit, corporate governance, surveillance, international audit standards, European directives

## **1. Introduction**

The world economic crisis, especially in the euro area, has produced very different interpretations with regard to the identification of the real causes, actual failures of many measures and governance systems, searching for guilty persons in many directions but not where they are.

Obviously, major financial institutions have had a decisive role in the collapse of the markets. The more acute lack of cash is related to the operational activities, with the activities of some characters who are members of the top management in different companies, to the faulty

functioning of internal control, to the impossibility of detecting frauds as a result of some arrangements between administrators, accountants and auditors etc.

All these have induced the idea that a link exists between the managerial inefficiency and the fraud that creates a false image of reality; the link itself is kept secret by professional accountants, mainly statutory auditors, those who certify the annual accounts, especially the consolidated accounts (Danescu, 2007).

Obviously, one cannot deny that there have been cases that prove the allegations are founded as the above one, which is not a general remark, but individual failures, especially in the field of monitoring the quality of the auditors' work.

## **2. Description of the current situation**

Starting with June 2008, Directive 2006/43/EC enters in force and is going to be implemented in the following years, many states postponing including it in their own legislation or refusing to apply the provisions referring to public surveillance, clearly stipulated by the Directive itself.

According to the opinion of the professional organizations, it was a great bewilderment about the changes brought about by an unimplemented directive and the consequences of which cannot be evaluated.

The European Commission has moved sharply in 2010 to proposals for amendments to the Directive citing the need for a better supervision, although the European professional bodies have themselves quality control, especially professional bodies that are members of the European Federation of Accountants (FEE), as well as the fact that the membership of the International Federation of Accountants (IFAC) requires explicitly quality control, including the competent supervision of the profession of financial and statutory auditor.

The European Commission considered that unattended profession can create a damage to the independence of the some auditors by providing both basic services – statutory audit – and non-audit services, without taking into account the alternative that if the same customer cannot obtain these services from the same auditor may shrink anyway from another, but maybe more expensive.

This controversy regarding who is right and what are the real reasons of the forecast changes has pointed out that any discussion has a positive role, including the need for the application of International Standards of Audit in the statutory audit, the way to get a professional opinion, having a correct and comprehensive framework, known by investors, with very demanding professional requirements, and the views expressed are reliable (Lepadatu, 2009).

It is worthy to add that a series of consultative meetings took place at the European level, more representatives of the professional and business environment being invited to attend, taking into account the proposed amendments. The consultative meetings lasted over a year and

pinpointed that there had been no opposition to the intention of the general framework on financial audit in general and the statutory audit, in particular.

The consultative meetings aimed at the following aspects:

- consolidation of statutory audit missions related to the entities of public interest;
- improvement of corporative governance within the audit companies;
- exclusion of contractual terms that direct and limit the appointment of statutory auditors;
- role of the audit committee according to the corporate governance;
- a better coordination, at the communitarian level, related to the monitoring of the audit profession.

Some authors have considered that after consultations, some provisions of the proposals advanced by the European Commission can be regarded as excessive in relation to the role of the statutory auditor (Morariu, Domnisoru, Cercel, 2009).

Consultative meetings were held in all Member States of the European Union with the purpose of gathering more opinions, views, arguments for or against the amendments in full or in certain aspects, the conclusions being put forward to the European Commission and the European Parliament. Certainly, all consultative meetings were quite efficient, aiming at laying down a legislative form, a directive or a regulation, the Member States being obliged to introduce it in their national law.

The difference between the directive and the regulation is important, however, as the provisions of a directive is assimilated by the national law in two years, and the regulation enters in force once with the date of enactment.

### **3. Analyses And Evaluations**

Activity of statutory audit is well defined and any modification results into concerns or turmoil to defend what has been achieved along the years.

In spite of all these, the debates have highlighted those aspects that require reconsiderations and adjustments in order to be more comprehensive and in accordance with professional performance. Some of the proposals may be considered useful and taken into consideration in modifying the current legislation.

### **4. Change through Directive**

A – *The comprehensive definition of public interest entities* (public interest entities are defined as being entities that, through the legislation of the member states, own transferable securities admitted to trading on a regulated market of any member state, credit institution, insurance companies, institution of payments, investment companies etc.

*B – Reassessment and change of property rights:* the present directive provides that a majority of the voting rights in an audit firm must be owned by licensed practitioners.

This provision is not present in the forthcoming directive, and the Member States are not allowed to require, through national rules, for a minimum of capital or voting rights in an audit firm be owned by the statutory auditors or auditing companies.

A positive element is that the current requirement is that the majority of the members of the administrative or management body of the audit firm must be statutory auditors.

Removing the existent restrictions supports the development of medium companies, allowing them the access to audit missions, as well as the elimination of the monopole of the four biggest audit companies.

*C – Introduction of the European passport for auditors:* audit companies will be allowed in a host member state if they make proof of registration in the origin member state, and the associated – partner is necessary to be locally authorized.

There are introduced facilities for self-employed who could stand for skill test if they performed the activity for at least three years under the supervision of a locally popular auditor.

*D – Obligation of using International Standards of Audit (ISA).* In this respect, it is stated that all statutory audits missions shall be carried out only on the basis of ISA documents issued by *IFAC*.

If member States are bound by the provisions of national law which have not yet been laid down in standards, they may apply to additions, starting with the ISA. Also there will be notes on the fact that SMEs will have to apply in proportion to the ISA in audits of their financial statements, and Member States must ensure the application of this provision.

*E – Professional independence of the competent authorities of the Member States.* This is the most restrictive provision in comparison with the current directive in the period as the competent authorities of the Member States may not delegate in full the tasks of professional bodies, but only the approval and registration of auditors.

For this reason, the Member States with regard to all other domains (the adoption of standards, life-long professional education, quality assurance and investigations and sanctions) will overtake their direct responsibility. This is the most worrying aspect in terms of liberal profession.

## **5. Change through regulation**

Aspects considered for this hypothesis:

### *1 – Clarification of some conditions related to the statutory audit process*

The special conditions refer to: independence, ethics rules, internal organization, the existence of an audit file, conditions which are included in the standards, but it is desirable to reveal them in the bureaucratic activity of the profession, too.

### *2 – Appointment of statutory auditor*

In achieving this objective, the role of the audit committee is highlighted by setting out the details regarding the appointment of the auditor and the duration of the mission, additional issues related to the requirements of the annual report.

As for proposals, the most important element relate to the introduction of mandatory rotation of audit firms after a maximum of 6 years (with some exceptions, the period is extended to 8 years).

At the same time, it is desirable to regulate a period of four year pause before the audit firm may be contracted again. The project also has some audit exemptions and in case of mixed audit, the rotation is allowed to take place after 9 years.

### *3 – Surveillance of the auditors of the public interest entities*

This chapter provides for the introduction of specific requirements for inspectors, but also for those who are employed as experts. At the same time it is expected that inspections and investigations be conducted jointly by the competent authorities of different Member States, once with the adoption of some guidelines relating to inspections and cross-border investigations etc.

### *4 – Introduction of the European Quality Certificate*

The provision grants that getting and using such certificate is voluntary.

### *5 – Introduction of specific requirements for great public interest entities*

Public interest entities shall be required to hold an open and transparent procedure in the selection of the statutory auditor, in accordance with corporate governance.

### *6 - Non-audit services*

According to this chapter, audit companies are not allowed to provide non-audit services to audit clients. At the same time, the big companies are held responsible for separating the auditing activities from the non-audit ones, thereby ensuring risk avoidance in terms of conflicts of interest.

## 6. Conclusion

As a result of the public debate, the arguments for new proposals relating to the audit policy stand for an attempt from the part of the European Commission to counter the effects of the financial crisis in the future and a legitimate desire to prevent economic turmoil, similar disorders affecting the economy of the euro area within the European Union.

After almost a year of debate between the two committees, the Committee on Economic and Monetary Affairs and the Committee on Legal Affairs of the European Parliament seem to have reached a compromise regarding the way they should address the issue, in order to adopt the Parliament's position on the new changes in the audit policy. However, the European Commission has not taken account of most of the existing proposals made by the European Parliament, which is a very rare situation.

Professional accountants, as well as financial/statutory auditors resent a significant part of the positions supported by the European Commission, considering them as being out of the framework of the general regulation and comprehension related to the profession itself.

The expected effects are not justified either in terms of the company rotation or in connection with excessive surveillance, or with the overtake of some competencies by professional bodies, some of them with decades of experience and activity.

The audit profession is a self-regulated, which is reflected by the process of organizing and functioning the financial audit in the course of more than hundred years.

The road to nationalization is not only dangerous and risky, but it may lead to lack of professionalism, decrease of liability or ethics etc. Subsequently, the doubt cast on the future of the statutory audit is quite obvious.

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