

EVOLUTION AND THE NEED FOR AUDIT SERVICES IN ROMANIA

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Abstract: In this paper we intend to present the way of organization of the financial audit in Romania, the evolution of the number of entities that provide these services, the barriers that characterize the audit market but and their necessity.

Keywords : financial audit regulations, audit companies, professions, performance.

1. Introduction

Profession of financial audit in Romania has developed after 1990, due to the conditions imposed on Romania's accession by the EU, develops of business and diversifies the trade relations, but also due to aligning of Regulations in the country with the European Directives and International Accounting Standards, through the establishment of Chamber of Financial Auditors. This is a professional organization, independent legal person, public benefit, non-profit, with the role of organizing, coordinate and authorize on behalf of the State, conducting external audit activity in Romania.

The financial audit represents the work performed by the financial auditors in order to express an opinion on the financial statements or of their parts, exercising other assurance and professional services according to international auditing standards and other regulations adopted by the Chamber of Financial Auditors of Romania.

Financial auditors who have acquired this quality and are members of the Chamber, in their independent activities, carry out the following main activities¹:

a) Statutory audit of the annual financial statements and of the consolidated annual financial statements in cases provided by law;

b) The financial audit of the annual financial statements and of the consolidated financial statements of entities that have chosen to audit of the annual financial statements;

c) Review missions of the annual financial statements, of the consolidated financial statements and of the interim financial statements;

d) Insurance and other mission assignments and professional services in accordance with international standards and other regulations adopted by the Chamber;

e) Internal audit.

They may carry out other activities, such as:

a) Financial accounting consulting;

b) Financial accounting management;

¹ GEO no. 75/1999 on financial audit, republished in the Official Gazette. No. 598 of August 22, 2003, amended and supplemented

c) specialized professional training in the field;

In awarding the quality of financial auditor, the legal framework is Emergency Ordinance no. 75/1999 of the Romanian Government on the financial audit, as amended and supplemented, in conjunction with the Emergency Ordinance no. 90/2008 on statutory audits of the annual financial statements and consolidated annual financial statements and Regulations of organization and functioning of the Chamber of Auditors of Romania.

Individuals to get quality of financial auditors and members of the Chamber have to meet the following conditions:

- to be licensed of an economics faculty or another one and have completed with an additional training program in economics (according to norms issued by the Chamber, concerning the additional training programs supported by CAFR);
- to have experience in the financial and accounting activity at least four years;
- to promote the verification test on financial and accounting knowledge for accessing to the internship;
- to undertake a 3-year practical training in the financial audit activity;
- to satisfy during the internship the requirements of the Code of Ethics and professional in the financial audit;
- To promote the professional competence examination organized in the end of the internship.

Internationally, the occurrence of the audit services due primarily to the **capital market development**. Shareholders (and others) have imposed a number of requirements on financial reporting on the listed company performance based on trust granted by an independent and professional opinion of the auditor.

The literature of speciality put the occurrence of the audit services demand on behalf of four basic theories²: **Policeman Theory, Lending Credibility Theory, and Theory of Inspired Confidence and Agency Theory**.

In the case of *policeman theory*, launched in the early 1940s, the auditor is responsible for discovering the fraud as a policeman. Recent the financial scandals have contributed to reconsider of this theory and to launch a public discussion on the role of financial auditor in detecting and presenting the financial fraud.

Lending credibility theory appeals to the role that audit firms play by the audit of financial statements required to the managers, to increase the user confidence of financial accounting information in the corporate governance act.

According the *theory of inspired confidence* developed in the late 1920s, the necessity of audit services comes from the shareholders who wish to evaluate the performance of the company and to be remunerated for obtaining the profit, proportional to the size of the entitlements held.

From the perspective of the *agency theory*, originally developed by Watts and Zimmerman (1978), a firm is viewed as a contractual result in certain parts, called agents (managers) want to attract funds from other parties, called *principals* (credit institutions, shareholders, investors, employees) at a certain cost (interest, dividend, salary bonuses).

² Hayes, R., Dassen Roger, Schilder, A., Wallage, P., *Principles of Auditing. An Introduction to International Standards of Auditing*, Second Edition, Pearson Education Publishing House, 2005, p. 44-47.

In this case, the auditor role comes to support the principal to certify the financial information provided by the agents, contributing significantly to reducing the information asymmetry.

Auditor independence

2. Evolution of the number of auditors in Romania during 2000-2012

Since 1993 in Romania appear auditing consulting rooms constituting the Big Four group, as follows: 1993 - PricewaterhouseCoopers, 1995 - Deloitte& Touche & Tomatsu, 1995 - KPMG, and in 1999 - Ernst & Young.

In 2000, the assessment exam of the professional skills was first organized in the Chamber of Financial Auditors and established the Register of Financial Auditors in which are the natural and legal persons.

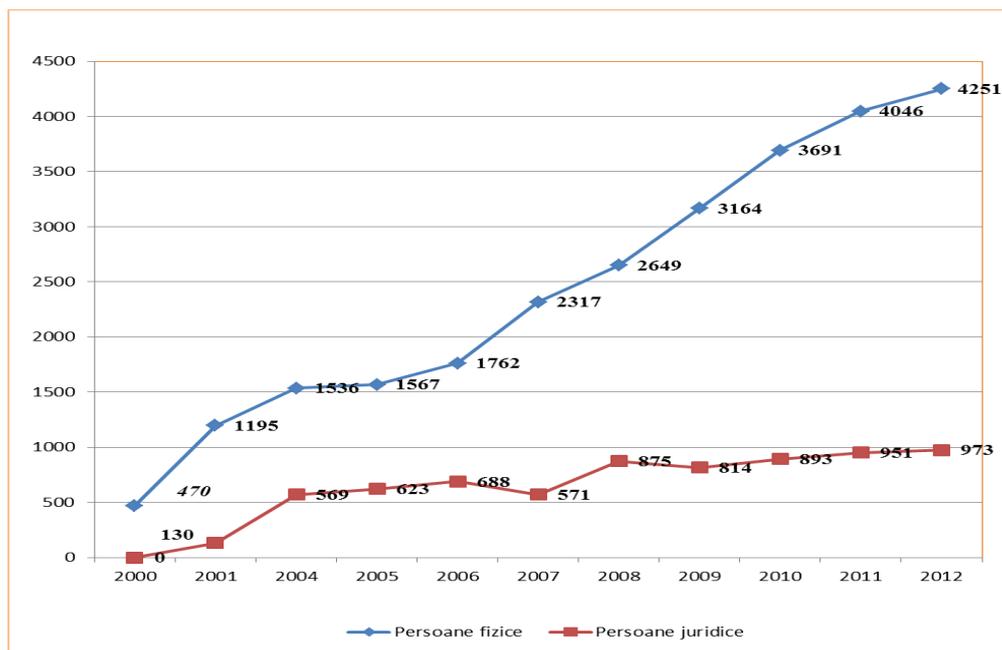
As shown in **Table no. 1** Evidence of the persons in the register is made on two levels, so it results active and non-active members.

Table no. 1 Evolution of the number of the financial auditors

Categories	2000	2001	2004	2005	2006	2007	2008	2009	2010	2011	2012
Individuals	470	1195	1536	1567	1762	2317	2649	3164	3691	4046	4251
Active individuals	382	979	1280	1277	1465	1927	2203	2706	3134	3431	3656
Non-active individuals	88	216	256	290	297	390	446	458	557	615	671
Legal persons	0	130	569	623	688	571	875	814	893	951	973
Total	470	1325	2105	2190	2450	2888	3524	3978	4584	4997	5224
Percentage of growth (%)	0	181.9	58.87	4.04	11.87	17.88	22.02	12.88	15.23	9.01	4.54

Source: Data are taken from the Reports of activity of the CAFR in the period 2008-2012

Figure no. 1 Evolution of the number of the financial auditors in Romania during 2000-2012



As it is shown in *Figure 1* both the number of persons in the category of individuals and the legal persons had an increasing trend during 2000-2012. Thus, from 470 individuals who were in 2000 reached 4251 in 2012 increasing being 9 times.

The most significant increases was during 2000-2001 and after 2007 the year when Romania entries into the European Union. In 2007 it is recorded in the Register of Financial Auditors 555 people, in 2008 still 332 people in 2009 another 515 people in 2010 still 527 individuals in 2011 still 355 and in 2012 still 205. It is a sustained growth of the desire for economic development, characteristic for the post-accession periods of the EU member countries. We see a moderation in growth for 2012.

Of the total number of active individuals and legal person, not all submitted Report of activity and not all recorded income from audit activity.

We present below the main results of a study by auditing, consultancy and accounting CRG Nexia Romania on the audit market, accounting and consulting in Romania³.

- In 2011, the top of 300 companies in the field posted a total turnover of about 206 million euros, an increase of about 5% compared to 2010. The largest weight in the total of turnover generated by accounting firms, consultancy and audit was held at the national level by the first four companies with CR4 of 67%. Top 30 of the standings remained dominated by the member firms of international network of accounting, consultancy and auditing which holding over 96% of the turnover of the segment at the end of 2011. Firms from middle (places 5-30) showed a slight decrease in the market weight from 22% in 2010 to 20% in 2011, while the other firms in the field have maintained weight of about 12%;

- The largest four companies of consulting and audit in Romania are the local representatives of PricewaterhouseCoopers, Ernst & Young, KPMG and Deloitte, known as BIG4. Their income fell by 11.42% to 558.3 million lei in 2010 compared to 2009;

³ http://www.consiliulconcurentei.ro/uploads/docs/items/id9017/evolutia_concurentei_in_sectoare_cheie.pdf

- BIG4 maintained their leading position among providers of auditing, accounting and consulting services, but their market share has been declining in recent years. So, the CR4 decreased from 76.52% in 2009 to 72.12% in 2010;

-Market share of the following six companies increased from 10.75% in 2009 to 14.5% in 2010, while the companies in places 11 to 25, the rate increased from 9% in 2009 to 9.20% in 2010;

- Companies after the 25 place increased from 3.72% in 2009 to 4.17% in 2010.

At EU level, BIG4 checked 90% from the balance sheets of the large companies and of the listed companies⁴, a situation which the European Commission describes as “in essence as an oligopoly”. This thing draws attention to the barriers faced by the remaining companies of audit and demonstrates the need for more diversity in a highly concentrated market, especially in the first four audit firms - Ernst & Young, Deloitte, KPMG and PwC.

The audit firms from the second tier, such as BDO and Grant Thornton, have developed a long company in an attempt to induce the authorities to reduce the barriers faced by smaller competitors in this market, but BIG4 have so far managed to dilute or block more proposals in this regard.

3. Challenges and barriers imposed by the market services of audit

Smaller companies of audit and especially individuals have to face many challenges and barriers to enter on the market. Among them, we mention:

- capacity and reduced size in terms of number of employees auditors;
- strong preference of the large companies to BIG 4 mainly because of the reputation, the reluctance between the companies and the lack of incentives to change the audit firms;
- The increasing requirement on the audit market for the expertise in the field where activated the audited companies;
- Impact of technology on the audit process. Although the companies from the second tier realize the necessity to increase the professional skills, costs and risks of listed audit companies can not be assumed.

If these obstacles are not addressed, the degree of concentration on the audit market at the BIG4 level could increase even more in the near future. In response to the described situation on this market, the EC proposed in 2011 a series of directives aimed at regulating tougher the auditing industry that is perceived as an oligopoly. Specifically, the draft law proposed in November 2011 aims to restore confidence in the financial reporting by forcing large audit companies to abandon consulting operations and to make place on the market to smaller competitors. According to the project, the companies with assets greater than one billion euros would be required to hire two firms of audit for the financial reports, including at least one from outside of the group of the four largest players in this market. Double audit seems to be the main measure in reducing the short-term focus: France is the only Member State that uses double audit, therefore having a concentration ratio below the European average and an audit firm from the second tier is found on the primary market segment.

⁴ According to the results presented in the final report entitled „Study on the effects of the implementation of the acquis on statutory audits of annual and consolidated accounts including the consequences on the audit market” and published in November 2011, Paris, authors: Joëlle Le Vourc’h și Pascal Morand, ESCP Europe

Also, an audit firm may work for a company with assets greater than one billion euros for a period between 6 and 8 years or, in cases that are assigned to two audit firms, between 8 and 12 years. Such rotation required is intended to strengthen the independence and competition in the accounting auditors. In this respect, it is important to note that currently, some large companies are working with the same firm for over 100 years.

Some advantages and disadvantages of collaboration of the Romania firms with large audit firms

- ✓ reputation of large companies is more popularized,
- ✓ recognition internationally of the large audit companies;
- ✓ provides greater confidence than small companies;
- ✓ run time of the audit mission is much lower, more people working on an audit mission;
- ✓ efficiency in the work carried;
- ✓ quality of the services is superior to audit by small companies;
- ✓ deviations in the quality of the services are less likely;
- ✓ Interpretations of standards in the same manner by all large audit companies.

Also, as a disadvantage of large audit companies can be considered the high price practiced compared with smaller ones.

4. Necessity for auditing services

In Romania, according to the provisions Public Finance Ministry Order no. **3055/2009** are subject to audit activities those entities that exceed two of the following three criteria for two consecutive years. Auditing of the financial reports will begin in the second consecutive year.

These criteria are: total assets - 3,650,000 euros, turnover - 7,300,000 euros, number of employees - 50.

In addition to these types of entities that are subject to audit, in Romania are subject to statutory audit: credit institutions, non-banking financial institutions, insurance-reinsurance entities, authorized entities regulated and supervised by the Council for Supervision of Interest of the Accounting Profession (CSIPPC), financial investment companies (Financial Supervision Authority - FSA), companies whose real estate are traded on a regulated market, the companies belonging to a group (consolidated), the financial statements prepared for the reorganization, companies benefiting by subsidies from the state or EU, companies that have opted for a financial audit.

For accounting information to meet the requirement to reflect a true and fair view of the assets, liabilities, equity, profit or loss (According to IAS 1 "*Presentation of Financial Statements*"), the financial statements should fairly present the financial position, financial performance and cash flows of a entity. Fair presentation requires the faithful representation of the effects of transactions, of other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the Framework) (IASB, 2013, p. A549). Such the accounting information must meet certain QUALITY CRITERIA.

Main qualitative characteristics that financial information must meet in the IASB's vision to be useful to the existing and potential investors, lenders and other creditors in the decisions they take are: relevance and faithful representation. Besides the fundamental qualitative characteristics, the financial information is accompanied by the qualitative amplifiers characteristics, namely: comparability, verifiability, opportunity and intelligibility. In compliance with these quality characteristics contribute substantially the auditing activity.

Next we present other arguments regarding the importance of audit services for both external users of information and entity⁵.

a. For users of accounting information or other nature, the audit aims to “**reduce the risk of information**”. Auditors being competent and independent provide a reasonable assurance on the information based on which users take different decisions, reflects the true image, are collected, processed and presented in **compliance with predetermined rules and sincerely**.

Decision makers are required to substantiate their decisions based on information provided by others. Interests of the information providers may not coincide with those of users. As a result, data can be manipulated in the interest of the bidder, leading to **misinformation of the users**. So, the debtor entity, manipulating information, it directs the lender to accept lending.

This misinformation may be **deliberate** when it presents incorrect information insincere or incomplete in order to conceal some fraud or distortion of the results, or may be **unintentional** due to some mistakes or due to honest optimism of those who provide information through the failure of accounting prudence.

Informational risk should not be confused with economic and business risk. Investors when making decisions to buy, to keep or sell shares and bonds; providers agree to deliver the goods on trade credit; bankers when agree to grant a credit etc., take into account both the **economic risk** of the business partner, the risk that it can not reimburse the debt or fail and the **information risk** that is to that consists in probability that based information on which is estimated the economic risk to be erroneous.

The auditors have no direct influence on the economic risk; they do not decide on the durability and effectiveness of the business, however, they have a significant influence on the information risk. Audit provides a better distribution of the resources according to identified risks, helping to improve the decision makers. Thus, if the bankers are happy with the level of information risk, they can reduce the interest rate, in these circumstances the audited entity raise funding sources at lower costs.

b. Users of information usually **can not check** the quality (regularity and sincerity) the information on which it based its decisions. They also can not **obtain direct information** about the transactions and operations that occurred. As a result, users of information are obliged to base on the information provided from other people because at least the following three reasons:

- Increasing the **distances** between places that collect and process the information and their users;

⁵ **Oprean Ioan**, *Auditarea situațiilor financiare- support course*

- Increasing the **volume** of transactions, increasing the possibility that some wrong information to be hidden by a pile of other information, these conditions the erroneous information are harder to detect, especially in condition of IT using.

- Carrying out the **complex** operations such as purchases of other entities, using the derivatives financial instruments, consolidation of accounts of entities (subsidiaries) of different branches, etc., and making judgments based on the accounting records (value adjustments). Checking information about these operations can be done by users who usually do not master the audit procedures.

Due to these reasons, the users have not the opportunity (time necessary, knowledge required, etc.) to obtain direct information or to verify personal information provided by others.

Verification of information by each user by moving them where they gather and process this information is inefficient because:

- High costs incurred by these movements, and due to repeated checks of the same information by each user through the specific objectives;
- Quality checks. Not all users have the necessary professional competence to carry out these checks and do not have standards or technical standards of work, checks were done by intuition and inspiration to each user;
- Confidentiality of information that cannot be provided to all involved persons.

c. Those that collect process and present internal and external information if they know that they will be audited showed a greater requirement, **respects more rigorous criteria and established procedures.**

The most convenient way for users to obtain reliable **information** (useful for a while and secure for the objectives pursued) is based on the services of the independent auditors, competent and operating on the basis of rigorous standards or norms. They offer a guarantee on the fact that the information is complete (exhaustive) are real (verifiable and justifiable) are accurate and unbiased.

The financial audit is conducted by competent and independent professionals and they are authorized to do so. These professionals are called upon to provide reasonable assurance on conformity of the financial statements with predetermined criteria. This insurance is provided to information users as an opinion expressed through the audit reports.

Conclusions

- Auditing activity in Romania is organized by the Chamber of Financial Auditors under the Government Emergency Ordinance 75/1999 on financial audit,
- Number of members increased from 2000 until 2012 by nine times, we can say that it is a relatively high number compared to other professions. This increase was due both to EU accession and changes arising from the transition to a market economy;
- Barriers to entry on the market are primarily generated by the qualitative requirements imposed to the profession and secondly by the existence of reputable companies and market power.

On audit market can say that both in Romania and in the EU it is owned of 70-90% percent by large companies of the Big Four group that includes PricewaterhouseCoopers, KPMG, Deloitte and Ernst & Young.

In 2011, largest weight in the total of turnover generated by accounting firms, consultancy and audit was held at the national level by the first four companies with CR4 of 67%.

At EU level, BIG4 checked 90% from the balance sheets of the large companies and of the listed companies, a situation which the European Commission describes as “in essence as an oligopoly”.

To remove this barrier we propose reducing the level of indicators by which is done the audit of financial statements in Romania, which would allow the smaller firms access on the market.

Also, we advise the individuals’ auditors, to cooperate in establishment of the audit firms. These have the advantage that with a large number of employees can audit large companies and can cover large territories.

- Necessity of audit is justified, especially in these conditions of economic instability by the following arguments: the role of accounting information to reflect fairly the assets, liabilities, equity, profit and loss, reducing the information risk, a more responsible attitude to those who are audited to respect the established criteria and procedures, reducing the cost of collecting the information from the external users.

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