

Audit and External Informational System

Prof. Sorinel Domnişoru Ph. D
Assist. Sorin-Sandu Vinătoru Ph.D Student
Mariana Gîrbaci Ph.D
University of Craiova
Faculty of Economics and Business Administration
Craiova, Romania

Abstract: The article describes in a real and elaborate manner the aspects concerning the correlation between statutory audit and the financial communication provided by the entity, by means of financial statements. In order to avail of a complex image of this issue, we have begun by stating clearly the importance conferred on the financial communication supplied by the entity, particularly, when dealing with companies quoted on Stock Exchange, which enables us to observe the reason why certain objectives concerning the external communication should be covered by IFRS together with accounting standards. Simultaneously, the audit standard, as part of operational mechanisms necessary for the economy and the success of capital markets, has been reconsidered to improve the financial communication of the entity with the environment in which it operates. Therefore, we may consider the audit as a means of developing a high-achieving communication, concerned with the users outside the entity and required for the management performance.

JEL classification: M41, M42

Key words: audit, financial communication, financial statements, decisions, transparency.

1. INTRODUCTION

Communication, considered one of the seminal theme in the origin of cybernetics, represents, beyond any argument, one of the society „bindings”, moreover, we may claim that in the absence of communication, people cannot exist. To communicate means, on one hand, to observe, to experiment and to learn, and on the other hand, to feel and wield our influence over the business environment, so that, our deeds become subordinated to a highly argued purpose. Narrowing the realm, we may affirm that the financial communication meets the stakeholders needs within the company, brings together entities, by means of a constructive dialogue of knowledge and efficiency in the field of economic activity.

A constructive financial communication reveals the business stability, which enhances public reliability. On the opposite side, the lack of transparency within the company, regarding its financial results, arouses public distrust, throwing a „shadow” upon the entity. Against this background, our aim is to emphasize the relation between the statutory auditor and this informational system, and, in order to reduce specific risks, to show the need for such realtion and how it strikes in the entity communication with its universe.

2. WORKING/RESEARCH METHOD

The volume of financial communication directly depends on generalized evolutions. Therefore, the economic globalization occurring for a long time as a phenomenon generated by unchallenged facts, embracing complex forms, sometimes becomes a demanding process. Its recent boom created new issues, impossible to solve by applying the same strategies available long ago. Globalization has been stimulated by the creation and development of multinational companies, and the financial communication area, as the major objective of these corporations, often meets specific demands of accounting standards, so that the net result – financial statements – may provide the information required by the parts involved and/or concerned. In the van of this process, great corporations have been constituted, but the activity of an entity could not be conceived outside the environment in which it operates and evolves, because this environment provides all its means, enabling the valorification of products or services, the administration of returns and payments etc. The entity background or universe comprises a correlated joint of factors – natural, economic, financial, technical, legal, demographic, social and political factors – influencing the company activity.

In this context, the periodical review of financial reports fairly presented by companies listed on stock exchange becomes a necessary condition. Gradually, these reports have overpassed the stage of simple sequence of figures, becoming an important marketing instrument..... At present, not only the companies listed on stock exchange disseminate data concerning profits, returns, turnover etc. A solid financial image facilitates bank loans, different financings, conferring reliance to potential investors, therefore, creating the opportunity for a profitable sale of the company etc. An adequate image is build-up through the communication of the entity with the business environment in which it operates. The role of the financial communication should be that of providing protection, and in the same time, of enhancing the value of the company shares. The financial communication may be theoretically and practically highlighted by investing in the company shares, by informing the existing or potential shareholders and by identifying, educating and satisfying the perceptions of the target public.

It is more than obvious that lacking of financial communication, corporations should develop their activity in an isolated environment, in many cases, nonstarter, we may say „barren” enough. Therefore, we may affirm the fact that financial communication registers a central position in the economic universe of enterprises and of corporations, constituting the „respiratory system” which allows the oxygen exchange with the economic environment. But how does this communication really occur?

Firstly, the investors, as well as other categories of stakeholders, need and undertake information concerning the entity activity from several sources: news media, stock exchange, financial statements, directly from the source etc. In other words, the financial communication specific to the organization does not consist only in periodical publication of financial statements, but it stands for reference of its activity through relevant disseminated data. Moreover, upon the analysis of these data, the addressees of financial statements transmit to the issuer entity different „signals”: they sell or buy movables launched by the company on the market; they establish strategies for development, consolidation and amortization of invested capital in a certain rhythm or the winding up of the enterprise; they discount or mark up, broaden or restrain the credit; they adopt a calm, passive or a concerned attitude regarding supplies

substantiality, sales and returns continuity or job stability etc. This circuit achieves the feedback of the communication between the entity and its universe. Synoptically, these correlations are graphically represented in the figure bellow, as an excerpt of the information flows instituted between an entity and its economic environment.

The enterprise surroundings include a unit of elements, different as nature – political, social, economic, scientific, technological, legal, cultural, psychological, geographic, ecological etc. – manifested on national and international level, influencing the entity activity not in an individual manner, but in their interrelation. This environment does not provide a structure able to answer to the enterprise perspectives and interests, on the contrary, most of its components may be unfavourable, therefore, the organization should constantly adjust to environmental changes, and this adjustment implies, first of all, knowledge and information. A series of relations of mutual influence exist between the enterprise, as an open system, and its surroundings. We may observe a strong connection between the information posted by the organization and the effects on the organization activity, generated by the decisions managed by people involved – using these data. The information registered in the financial reports reveals a wide area and, considering the content, it represents the knowledge and activity repertory specific to the organization, as well as to stakeholders. Its dynamic character is revealed by the continuous movement of balance sheet elements, capital, output and sales, value, costs, profit and cash flows, and, on the other side, by the natural desire of persons concerned with the issuer entity activity to adopt the right decision – all these aspects generate and develop financial information with a two-way circulation. The development, storage and processing of financial data, their full availability and organization on domains of interest, have been facilitated by the information technology, by modern information systems and on-line communications. Under these circumstances, it is obvious that the adequate financial management implies fair transparency of actions, movements and changes, of results and accruals related to and within entities.

In practice, the financial reports represents the "public statements of the management", an effective way for the organization to communicate financial information to a wide range of users of financial statements: direct or capital market prospective investors; employees; financial institutions, banks or lending companies, suppliers and other creditors; customers and other debtors; government and its entities, general public. The preparation of financial statements demands compliance with applicable laws and regulations from the part of the management, the assessment and use of adequate accounting policies, as well as the performance of right estimations and arguments for the elaboration of the product of public concern.

The objective of periodical financial reports is to provide information about the financial position and performance, capital flows of the enterprise, as well as other information useful to a large range of users in adopting optimum economic decisions. Financial statements should give the opportunity of a relevant evaluation of the entity management and reveal its continuity and capacity of generating cash flows meant to pay dividends, suppliers, the personnel (wages), banks (installments to credits granted and accessories) etc.

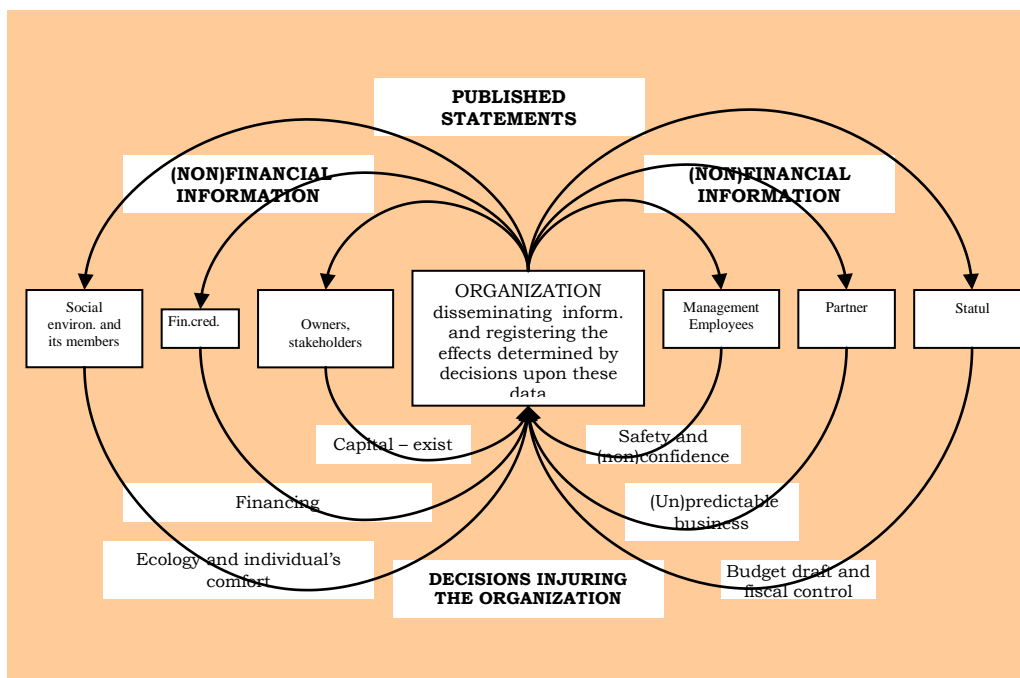


Figure no. 1 Correlation between organization and its "universe"

Through financial reports, the enterprise management prevalently communicates to stakeholders – who have entrusted them rights and duties for efficiently managing significant resources – the result, profit or loss, at the end of each financial exercise. For this reason, the financial statements performed serve as arguments for different aspects of managing entrusted resources and for the results achieved, as well as for the estimation of perspectives.

For a better understanding and application of these financial reports by a larger number of users – as determining „vehicle” of financial communication – the IASB has elaborated the International Financial Reporting Standards (IFRS) – meant to globalize all financial and accounting information included in these reports. The European Union and national institutions of standardizing accounting rules in the U.S.A. and in the United Kingdom of Great Britain have made a commitment, in 2002, to develop a broad process of convergence between different accounting systems and to elaborate new standards applicable in all countries, starting with 2005¹.

The standards forming part of IFRS are conceived to establish a balance between information of accounting technique, promoted by the International Accounting Standards (IAS), and financial information. Financial statements, considering these standards, underlie, develop and itemize accounting policies and options, together with the reports including financial aspects and methods for protecting and managing the entity resources; the alternatives used for identifying assets, capitals and debts, for reflecting incomes and expenses, and business activities which have determined the financial result, dividends and the main economic-financial indicators etc.

¹ Al. Rusovici și colab., „Manager în misiunea de audit”, Editura Monitorul Oficial, (Manager in Audit Mission), Official Journal Publishing House Bucharest, 2008, pag. 430-442.

This brief presentation reveals the fact that the conceptual support of the informational system of public interest is provided by the regulatory authorities, but the effective content and the way of expressing are operated by the business entity. As a consequence, we may already observe inherent deficiencies of this type of communication, and there is no way to avoid this. The residual informational risk persists.... The computer, the information and communication technology have dematerialized the financial information enhancing its reliability, as well as its global circulation in real time, but, these aspects have facilitated the fabrication of "unfair acts" by informants.

Following this direction or leading an objective study, we inevitably reach the „creative” capacity of the accountancy. It may seem paradoxical for many of us, but it really happens!... and it happens frequently!... Therefore, we may assert that the way of leading the financial communication policy within an organization is more than predictable. According to Bernard Colasse - "What a strange instrument is accountancy!... Conceived as a method of describing the enterprise, it provides only partial images, often subjective and always ambiguous. Required as a need for information, for assistance during the control procedure and in making decisions, it proves to be misleading, fake, rhetorical and sometimes tricky. The accounting figure is, therefore, arguable and we reason whether we find its complete social profitability, considering the issues it creates and inflames, playing a role of mediation between social players who acts together in developing the enterprise... and, after all, it is obvious that accountancy just defines an informational space where the account producers and users make themselves understood and probably understand one another."² Hereby, interpreting the results and their public presentation may influence the stakeholders' perception and behaviour. Financial engineering „achievements” try to reach accounting norm flexibility in order to acquire the most adequate forms of delivering information, meaning optimistic, if by chance, dearing forms, from the entity management perspective.

The use of a certain accounting norm allows the artificial modification of the result level. Taking advantage of legal loopholes or accounting rule omissions, the managers try to promote a flattering image. This accounting rambling encourages international unbalance, directing, thus, market operational status. The organization management appeals to all kinds of subtleties and to all opportunities to meet market expectations and requirements.

It is unanimously known that financial information reliability, highly based on accounting documents pertinence and validity, is relative. Creative accountancy, as an instrument of modelling accounting information for external users, obviously tries to improve their expectations and perceptions. This technique, placed within the limits of legality, aims at the „optimization” of the organization image from financial point of view, to the detriment of the idea of being strictly precise or objective. It represents the basis of communication and, unfortunately, it becomes a redoubtable weapon in the control of the unit management.

Enterprises make use of the opportunities provided by accounting regulations, and the quantification of the impact generated by accounting policies and options being a difficult task for information users. Among the factors determining an influence on the selection of the financial statement tone, we may mention: the economic general

² Colasse B., Encyclopédie de gestion, 2^e Édition, Ed. Economica, Paris, 1997.

framework;³ the company local/global policy, market/field of activity characteristics and competition etc. For example: there are IT companies which communicates only gross financial results; there are car manufacturers communicating only the number of vehicles sold; there are companies in the financial field announcing only percentage increase. The organizations may choose between the dissemination of results using a certain currency, using the number of products or percentage evolution, but the examples generated are assigned as marketing instruments. They do not reach the status of assertive communication. Some business entities do not focus on the dissemination of financial information considering the value of financial result (of actual performance), but, in order to persuade the public, they insist on past and future evolutions. Other companies point out the president's speech „haistily” mentioning the result, indicating other key – „relishable” figures/information in a more or less discreet manner, focusing the attention of concerned/involved parties on the wrong tracks. For other groups, the results indicate a connective character, unrelated to the center of the financial statements disseminated. When results are contrary to expectations, in order to reduce consequences, the evolutions of certain ranges of interest or on certain markets should be emphasized etc.

For this reason,⁴ distinctive elements have been introduced in the current international standard in order to distinguish it from the previous one, and it includes aspects which facilitates transparency and communication, more complex information towards financial statement users and the detailed portrait of the enterprise. Against this background, the performance of financial statements specific to the financial exercise becomes the expression of a financial communication which supports the understanding of the company activity and the group strategy. According to its new vision, the financial communication meets a strategic dimension where (beside the relations with the stakeholders, the creditors, the management and employees, the government institutions) the existence of the enterprise and its functions are highlighted through the relations with the public and the environment. The normative framework tries to provide a generous volume (synthesized and systematized – but, at the same time, significantly expressive) of (non)financial information⁵ very useful to users in knowing and understanding the enterprise position and condition, its performance, its activity profitability and efficiency, the fluctuation of liquidities and changes of assets level and structure during the financial exercise. Reliable information should indicate in a precise manner all transactions and events meant to be represented. In other words, a certain behavior is recommended and public responsibility from the part of the producer of disseminated financial information.

However, it is not enough to elaborate information meant to achieve the objectives⁶: sufficiency, objectivity etc. On the contrary, other means seem to be needed for providing an adequate financial communication. For example, before reaching the status of publishable information, companies gather financial analysts, placement counsellors, brokers and investors for an evaluation of annual results of the company, for a study of different financial forecasts and other relevant elements, allowing for the

³ For example, during this period of financial crisis, managerial approaches are totally distinctive from those registered during periods of economic stability.

⁴ More correctly - particularly for this reason...

⁵ Inherent situation, even if these statements are designed as financial, the performance of such 'product' considered as being complete, also includes non-financial data...

⁶Tending to achieve them.

exchange of opinions and ideas between the company's management and various investors (indirectly – under the board observation) the identification of strong and weak points, as well as the potential and risk of inadequate financial communication. In the case of listed companies, the publication of financial information implies a meticulous process as it may influence the share price. It is not by accident that such information represents the object of preliminary Stock Exchange Agreement and of reporting the Commission of Security Dealers (generally, the capital market institutions, including rating agencies).⁷

Having on one side the financial information producers who are not, or at least can not be totally neutral in considering the operations performed, and, implicitly, in regard to the information published, and on the other side, the addressees manifesting different degrees of understanding, there is a perpetual need for identifying the adequate solutions meant to improve information reliability, perception incidence and attitude quality of decision makers relevant for the organization, in a single phrase, financial communication reliability. One of the most important alternatives providing the achievement of this objective consists in statutory audit,⁸ supporting the informational thoroughness and accuracy. At the same time data are prepared for being published, the statutory audit interferes in the financial communication, by means of a solid examination meant to maintain the process within reasonable parameters, reducing the risk of triggering pressures and socially unwanted events – generated by a potential dissemination of financial information inconsistent with reality, by tempering the orientation of financial statements towards marketing, an attractive, but deceiving process!...

As a general view, we may consider the whole audit as a means of holding-up an adequate communication – a part particularly concerned with the 'receivers' outside the organization, while the other part is rather "staring at" internal administration and at the management 'service'... At the same time, we have the opportunity to answer the question why statutory audit and financial communication? The reason is very simple – due to the fact that statutory audit represents the pillar of financial audit, valences and exigencies being completely manifested in this situation. Moreover, conserving the statement at the level of the whole system, its presentation would be charged with elements, rather irrelevant.

Against the existing economic and social background, the statutory audit seeks to provide an assurance service, in the sense that, it warns and protects the ownership, board members, creditors, managers and employees, authorities and even the simple public, and ascertains the quality of information included in the financial statements published by different organizations.

After 2002, the international accounting standard has been significantly restructured in order to enhance the strictness of financial communication between the organization and its environment; the International Standards on Auditing have also been restructured from the same perspective. Thus, when publishing financial information, it is assumed that the auditor has already examined the main transactions, primary accounting and management documents, internal control system organization

⁷ C. Nicolescu, M.F. Pantea, Rolul contabilității în comunicarea financiară, Contabilitatea, expertiza și auditul afacerilor, nr. 3, („Contribution of Accountancy to Financial Communication”, Business Accountancy, Expertise and Audit, no 3) pg. 18 – 21, Bucharest, 2009.

⁸ The collocation "statutory financial audit" is considered a pleonasm.

and operation, verified the security and the authenticity of the accounting process reflected through the financial exercise's closure, concluded on the content of financial reports, on the declaration of transparency and compliance to the law imposed by the corporative governance and published the opinion revealed by the exercise of the concluded financial activity, providing a reasonable assurance to users of financial information. For this task the expert collects and evaluates the auditing evidence with professional scepticism, but he/she does not adopt the investigator attitude. The audit does not include a penal research and the auditor has not the obligation of being an expert in detecting frauds, even if the restructured standards attempt to require it. In our opinion, for a better understanding of the position occupied by the 'agents' within the financial communication specific to an organization, an important aspect which has to be observed is the 'discrepancy, considering the expectations' between the auditor's role perceived by the public, generally, financial statements users, and its real attributions. Public opinion, for example, considers that the auditor's role consists in: detecting the fraud and errors in financial statements; being charged with primary responsibility for the issuance of financial statements; acting in time to prevent a potential failure of business activity etc. In fact, the audit does not prevent business solvency or financial performance. As management performs financial statements, it is responsible for their content and, although, experts plans and develop an adequate commitment, an audit does not guarantee that fraud will be completely detected. What an auditor really can do is to provide financial strictness, better corporative governance and to report, if necessary, the suspicion or risk of fraud. The audit is part of operational mechanisms of the economy and of capital market success, if there is a stable and competitive audit market.

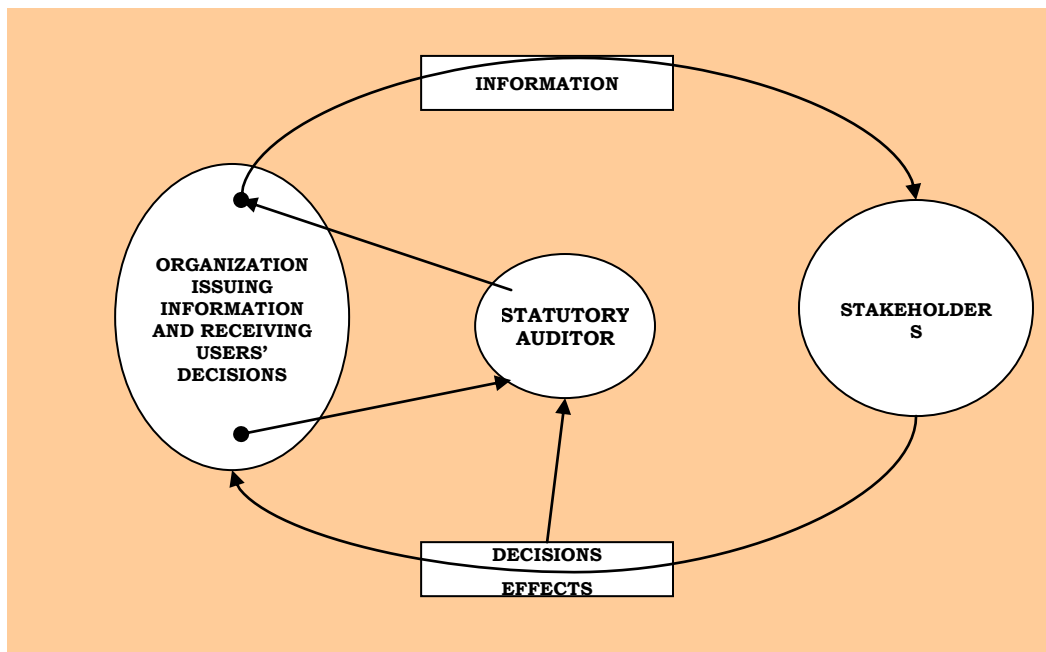


Figure no. 2 Position of statutory audit in the association of the organization with its "universe"

For a better understanding, we consider that the description of the statutory auditor's role and position in the financial communication of the organization with its world is very suggestive. Therefore, in figure no 2 we have placed the defender of informational accuracy in the 'scenery' of financial communication, narrowing the concerned/involved parties in a single generic category – stakeholders. As a convincing example, we may indicate the relation between the auditor, the entity submitted to the analysis and one of the concerned parties (its credit bank). As we have already mentioned, statutory audit usually interferes during the 'preparation' of financial statements by the organization, the approach period being in direct ratio to the size and complexity specific to the evaluated entity. According to the audit report (based on the results deriving from the investigation performed) the credit bank stays optimistic or becomes prudent, if not sceptic... On this basis, it may decide whether the credit is maintained or extended or, on the contrary, limited or completely withdrawn. These bank decisions may affect the reference entity, determining effects which the auditor, irrespective of the nature of his commitment, continuous/recurrent or not, has the obligation 'to monitor' them and even to react if they are not in conformity with his/her knowledge or estimations..... Moreover, the auditor as an assurance 'provider' is 'put in a bind' by the international professional and corporative standard, so that, his/her involvement in 'styling' the financial information published by the organization becomes limited. A relevant example is the tripartite relation established between the statutory auditor, the management (executive and administrative) and the entity ownership. Regardless the number and the efficiency of 'barriers' imposed by any regulation, we reach the human and professional quality.⁹ If ethics and public responsibility do not represent the main objectives of the persons involved, the financial communication of the organization with its economic world would be injured...

The role of the audit is not and can not be static – it should evolve simultaneously with the accountancy, organizations and society. For this reason, the profession controls and supports the auditors' activity in order to satisfy the growing demand concerning public responsibility and transparency.

ACKNOWLEDGMENTS

This work was supported by CNCISIS-UEFISCSU, project number PNII-IDEI code 393/2008, contract 861/2009.

REFERENCES

- O. C. Bunget „Audit financiar-contabil” (Financial Audit), Editura Mirton, Timișoara, 2010.
- B. Colasse “Enciclopédie de gestion”, 2 Edition, Editura Economica, Paris, 1997.
- N. Darnall, “Perceived stakeholder influences and organizations' use of environmental audits”, Accounting, Organizations and Society, vol. I. Seol, 34, Issue 2, Feb. 2009, pag. 170-187.
- J. Sarkis
- S. Domnișoru, “Audit și comunicare financiară”(Audit and Financial Communication), Tipografia Universității din Craiova, 2009.
- S. Vinătoru
- E. Engel, R. M. Hayes, X. Wang “Audit committee compensation and the demand for monitoring of the financial reporting process”, Journal of Accounting and Economics, Issues 1-2, Feb. 2010, pag. 136-154.

⁹ As a general view, it is an aspect which may manifest at the level of each control system conceived by the individual.

- C. Humphrey, “The global audit profession and the international financial architecture: Understanding regulatory relationships at a time of financial crisis”, *Accounting, Organizations and Society*, Vol. 34, Issues 6-7, Aug-Oct 2009, pag. 810-825.
- A. Loft,
M. Woods
- C. Nicolescu, “Rolul contabilității în comunicarea financiară”, *Contabilitatea, expertiza și auditul afacerilor*, nr. 3, („Contribution of Accountancy to Financial Communication”, *Business Accountancy, Expertise and Audit*, no 3) pag. 18-21, Bucharest, 2009.
- M. F. Pantea
- I. Oprean,
I. E. Popa,
R. D. Lenghel
- Al. Rusovici și colab. “Manager în misiunea de audit”, Editura Monitorul Oficial, (Manager in Audit Mission), Official Journal Publishing House Bucharest, 2008, paf. 430-442.