

THE ROLE AND THE PROFESSIONALISM OF THE FINANCIAL AUDITOR IN THE CONTEXT OF CORPORATE GOVERNANCE

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Abstract: *Debates on corporate governance are numerous and diverse. This study explores the role of the auditor in the context of corporate governance and researches on elements that might impact the audit process. The findings of the study are that auditor independence and professional judgement are key elements for reaching professionalism in financial audit. In turn, corporate governance is positively influenced by audit professionalism.*

Key words: *governance, auditor, independence, professionalism*

1. INTRODUCTION

There is a variety of academic contributions on the topic of corporate governance. This concept is dealt with from an array of perspectives: narrow and broad perspectives (Solomon, 2010), managerial perspectives (Huse, 2007), but also finance, legal and compliance perspectives. Here, corporate governance is understood as the way a company is directed and controlled, and, as Sison (2008) notes, as “the system of checks and balances, both internal and external to companies, which ensure that companies discharge their accountability to all their stakeholders [...]”. One of these accountability mechanisms is financial audit. This type of external auditing has been previously researched in connection with ethics and professionalism. The present paper builds upon the existing research and has the purpose to explore the relationship between auditor independence, professional judgment and professionalism in the context of corporate governance.

2. RESEARCH DESIGN

The research methodology is analytical and argumentative in nature: first, the concept and mechanisms of corporate governance are discussed; second, the auditor’s role is analyzed and arguments in favor of the existence of interdependencies between external auditors, internal auditors and audit committee are brought; third, the main pressures exerted on the financial auditor are analyzed, with reference to auditor independence; and last but not least, authors argue there is a strong relationship between auditor independence, professional judgement and professionalism on one hand and corporate governance on the other hand. Thus, the paper has the structure of an argumentative essay, whereas all arguments converge to the main concluding idea.

3. CORPORATE GOVERNANCE

Generally, corporate governance represents a set of relationships between the entity’s management, its shareholders and other stakeholders. From the perspective of agency theory, the owners of the resources (entity’s shareholders) play the role of principles, who entrust their resources to the entity’s managers (agents), for them to manage those resources and create added value. In order to ensure an honest, efficient and effective administration of resources, the entity’s shareholders, in particular and all stakeholders, in general, establish a group of mechanisms that build up the governance system.

Mainly, these corporate governance mechanisms are: the board, the audit committee, the internal audit function and the external audit.

4. FINANCIAL AUDITOR’S ROLE

The auditor’s explicit role is to issue an opinion on the financial statements of an economic entity. He concludes on whether they present fairly, in all material respects, the financial position and performance of the audited company. The auditor’s implicit role, on the other hand, is to offer credibility to the financial statements. This need for trust belongs to investors and other stakeholders due to the fact that the preparation of the financial statements is the responsibility of the managers entrusted with financial resources. These managers might be tempted to pursue their own interests and not those of the company’s shareholders. Thus, from the perspective of agency theory, auditor’s role is of monitoring and bonding in the contract between agent (manager) and principle (investor). Auditor’s work reduces the information asymmetries between shareholders and managers, who cannot be directly controlled.

However, financial audit cannot fulfill its role without interacting with other corporate governance mechanisms, among which the most relevant are the internal audit function and the audit committee. On one hand, internal auditors support financial auditor’s work in several ways. First, they can enable external auditors a better understanding of the internal control system. Second, they may assist in choosing a sample to be tested and in sending confirmation letters to debtors and banks. On the other hand, the audit committee has the task to monitor the activity of the financial auditor. It is essential for the auditor and the audit committee to communicate in an accurate and timely manner. Additionally, the audit committee monitors an important professional trait of the auditor: independence.

5. AUDITOR INDEPENDENCE AND PRESSURES

Audit and auditor’s work are intrinsically linked to the concept of accountability. It is generally accepted that one of the more important roles of an audit is that of monitoring and securing accountability. In fact, this is why audit is so important, mainly because it is a critical element in achieving accountability. However, a central point of audit and accountability is that of independence. The argument is that credibility can only be associated with persons seen to be independent of both the subject of the audit and of any interested stakeholders. Therefore, auditor independence clearly adds value to the financial statements by transforming them from unaudited information to credible information. In view of the importance of auditor independence, research done by scholars has identified possible areas of conflict between different groups of stakeholders. It suggested that, where conflict existed, pressures affecting auditor independence might arise. Therefore, the pressures the financial auditor must deal with are numerous. On one hand, the auditor-auditee contract leads to pressures related to the time budget, the negotiated fee or the existing competition (Arnold et al., 2001, pp. 326).

First, time pressures originate in the limited time resources allocated to performing certain tasks during audit engagements (Liyanarachchi and McNamara, 2007, pp. 62). Second, fee pressure acts in two different ways: (1) stimulated by the high level of fees, auditors may exert increased effort in the auditing work and thus they can offer higher quality audit services; (2) fees can create the appearance of an economic dependency on the client. Last but not least, auditors face competition-driven pressures. The client company may refuse their services, and chose another supplier of audit services (Mocanu, 2009, pp.12).

Factors of pressure on the financial auditor are also generated within the social contract. The interest of the profession and its members is to maintain their self-regulatory powers, and to offer at the same time an accepted level of audit quality. For accomplishing this interest, the profession issues new standards, improves the existing ones and revises entrance requirements (Arnold et al., 2001, pp. 326). The auditor is thus pressured to constantly adapt to such regulatory changes.

Ideally, both contracts can be satisfied by the financial auditor, to the content of all participants within the audit environment. For that purpose, the financial auditor ought to identify a solution that meets both the social contract and the auditor-auditee contracts (Arnold et al., 2001). Identifying this solution is not possible without exerting professional judgment and has no value without maintaining the independence of the financial auditor, in spite of all pressures.

6. AUDITOR'S PROFESSIONAL JUDGMENT

The financial auditor, as a professional in accounting and audit, adds credibility to the financial statements. Throughout his work, during the audit process, the auditor uses an element which is central and critical for its entire activity: professional judgment. Professional judgment in auditing is the application of relevant knowledge and experience in reaching decisions, within the context provided by auditing and accounting standards and rules of professional conduct. Professional judgment is the cornerstone for the audit profession and is applied in all stages of an audit, from planning stage to the audit opinion. Professional judgment is an integral part of audit and cannot be dissociated from it. In audit, there is a direct relationship between professional judgment and the financial auditor's professionalism.

7. PROFESSIONALISM AND ITS RELATIONSHIP TO AUDITOR'S PROFESSIONAL JUDGEMENT

Professionalism in audit can be identified with specialists that represent complex behavioral models, persons with a spirit of duty and accountability. Among the many characteristics of a professional there is creative thinking, critical analysis, attentiveness, elevated language, relentlessness and a fine overall equilibrium. But above all these there is the professional judgment which is part of every profession's definition. There is a close relationship between professional judgment and professionalism because professional judgment is present in every decision that an auditor takes during an audit and that has direct implications on the quality of the audit. In turn, the quality of the audit determines the level of professionalism but it has to be recognized that professional standards also play a prominent role. The quality of professional standards will definitely impact the professional judgment of the auditor and both will impact the quality of the audit work.

The professional judgment exercised by the auditor in the course of an audit together with the quality of the audit work will, consequently, impact the level of audit professionalism. Professional judgment takes place in the context of professional standards that reflect the collective judgments of the profession and the characteristics of a particular industrial sector. Hence,

the critical importance of professional judgment in audit appears as evident.

The absence of comprehensive professional judgment affects the financial auditor's professionalism and leads to a lower audit quality, to a negative impact on the process of corporate governance and to an increase in auditors' exposure to liability claims.

8. CONCLUSIONS

Corporate governance is an internationally debated interdisciplinary concept. Given the main directions which corporate governance covers, particularly directors, remuneration, accountability and audit as well as relations with shareholders, auditors play an increasingly important role within corporate governance.

The results of the present study are: (1) the clear identification of the roles of financial audit in relation with other corporate governance mechanisms such as internal audit and audit committee; (2) the significance of independence for the proper fulfilment of the auditor's roles, given the numerous factors of pressures on the auditor; (3) the arguing of the critical importance of professional judgement in the audit work; (4) the fact that auditor independence and professional judgement are key elements for reaching professionalism in financial audit; (5) the positive impact of audit professionalism on the process of corporate governance.

This study has certain limitations: it is mostly an argumentative and analytical work representing research at an incipient level and only provides a basis for the hypothesis development in a future empirical research. In fact, the research could be extended by conducting empirical studies on: how are the financial auditor's role and professionalism perceived by internal auditors, audit committee and board of directors and which are the factors that influence auditor's professionalism. Such further research would consolidate this paper's idea that financial audit is a significant corporate governance mechanism.

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