AUDIT – ASSESSMENT, INSPECTION OR CONTROL?

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ABSTRACT: *The emergence audit concept has created a lot of confusion, on the one hand between its manifestations, on the other hand between it and the indigenous concepts that are more suggestive and at the same time more explicit. Both theory and practice show that the abolition of auditors within companies that have been subject to financial audit was the result of confusion created between the audit and statutory audit. On the other hand, long it was considered that if was set up internal audit do not need control, something which has to be seen from another perspective given that fact in reality internal control includes internal audit. These are the considerations which, in this article we try to sit concepts in their natural order and to emphasize the implications of corporate governance codes on the audit function.*

KEY WORDS: *auditor, external audit, internal audit.*

JEL CLASSIFICATION: *M40, M42.*

1. INTRODUCTION

The extensive research has shown that the role of auditors is misperceived. But we cannot attribute the entire blame on the general public because the audit is a complicated subject, difficult to understand for those who have limited knowledge about the subject. In addition, the role of auditors and audit objective has always been dynamic rather than static topic. This is due to the strong influences from contextual factors, such as socio-economic status of a certain period, historical events important that occurred (for example, the collapse of large corporations) verdicts of the courts and tech news (eg System Evolution information). Therefore, any major change to these contextual factors could lead to changes in the audit function and the role of auditors. Consequently, their role is evolving permanent.

The role of auditors has not been well defined from the beginning (Alleyne &

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Howard, 2005). Porter (1997) analyzes the historical evolution of the auditors responsibility in terms of detection and reporting of fraud over the centuries. Her study shows that there is an evolution of audit practices and a paradigm shift in auditing, through a series of stages.

Porter's study shows that pre-1920 phase, the primary objective consists in exposing fraud auditing. However, in 1930, the primary objective of the audit was turned into checking accounts. This is most likely due to the increasing number and volume of transactions of companies, which, in turn, reduced the possibility auditors to review all transactions. During this period, the audit profession began to claim that fraud detection responsibility lies with management. In addition, management should implement adequate internal control systems to prevent fraud in their companies.

In the 1960s, the media and the public were generally unhappy that auditors refused to accept responsibility for fraud detection. The usefulness of an audit was often questioned because it failed to detect fraud. However, despite the criticism, auditors continued to downplay their role in detecting fraud, stressing that this obligation lies with management. Technological developments in the '80s, complexity and volume of incidents of fraud have raised serious problems for companies. Porter (1997) states that although case law has established that, in certain circumstances, auditors are required to detect fraud, the courts have tried to keep responsibilities of auditors within reasonable limits.

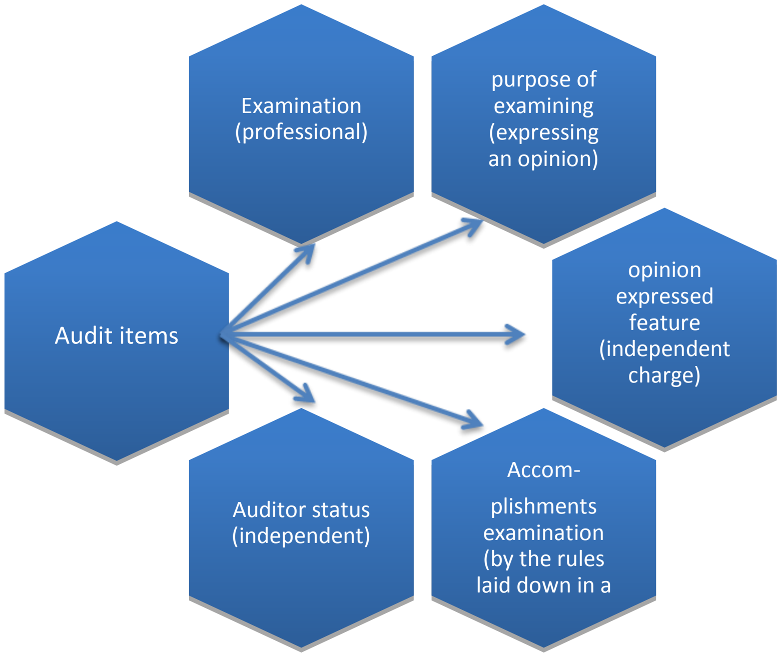
Unfortunately responsibilities of auditors on the detection and prevention of fraud have been and are misunderstood. In many countries, extensive studies have been conducted on the perception of users of financial statements the auditors obligation to prevent and detect fraud [ie, Beck (1973) and Monroe and Woodliff (1994a) in Australia; Arthur Andersen (1974), Baron et al (1977). These studies have shown that many users of financial statements believe that the detection of irregularities is a primary objective of the audit and that auditors are required to detect any irregularities.

2. AUDIT – ASSESMENT, INSPECTION OR CONTROL?

Of Latin origin, the audit term comes from the word „*audire*” that is „to listen”. With time, Anglo-Saxon practice used it strictly for revision of the accounts done by independent experts that provide an opinion on the operation conducted regarding their regularity and fairness.

ISO 8402 refers to establishing the audit quality term According to it, this is "a systematic and independent examination, conducted for ensuring that the activities and their results on quality, are in accordance with default forecast, that that orders are properly and effectively implemented for goals achievement ".

In the situation when though quality reporting to a standard or a norm is understood, then the definition provided by ISO 8402 can be generalized and can be used in terms of **responsible and independent opinion** in relation with the standard or the norm requirements. Regardless the type of audit that is done, its purpose is the improvement of the way the information is used, considering five main elements. This is presented in figure 1.



Source: author's own research

Figure 1. ***The five main elements of audit***

From initial checking of financial statements, the audit received new valances which split it into three audit categories:

- Financial audit that is used fir assessment of processes, transactions and financial statements, which is larger than statutory audit and legal one;
- Operational audit that is used for improving on entity's performance;
- Management audit that is used for analysing internal management.

As a fact, considering the way the audit is used, it can be pointed that **the audit can be** either preventive, when it tries to assess the efficacy of an entity, a process or a method or of provider's utility, or effective when tracking state of affair, even business bankruptcy.

Either we talk about external audit or internal one, we observe that they are on the same side and face the same "battle" supporting each other, even though they are based on different audit methods and practices.

Based on the research conducted by Jaque Renard (2002), both Romanian (A. Morariu, Gh. Suciu, F. Stoian, 2008) and foreign researchers (D. Lewis, 2015) established 8 difference between internal and external audit, but also similarities and complementarities of them. They are presented on table 1.

Hisham Sorour (2015) brings into question 15 major differences between internal and external audit, which is a combination of Jaques Renard view with D.Lewis perspective, that confers a new approach of the differences or that detach them from the difference highlighted by Renard.

Table 1. Comparison between external and internal audit

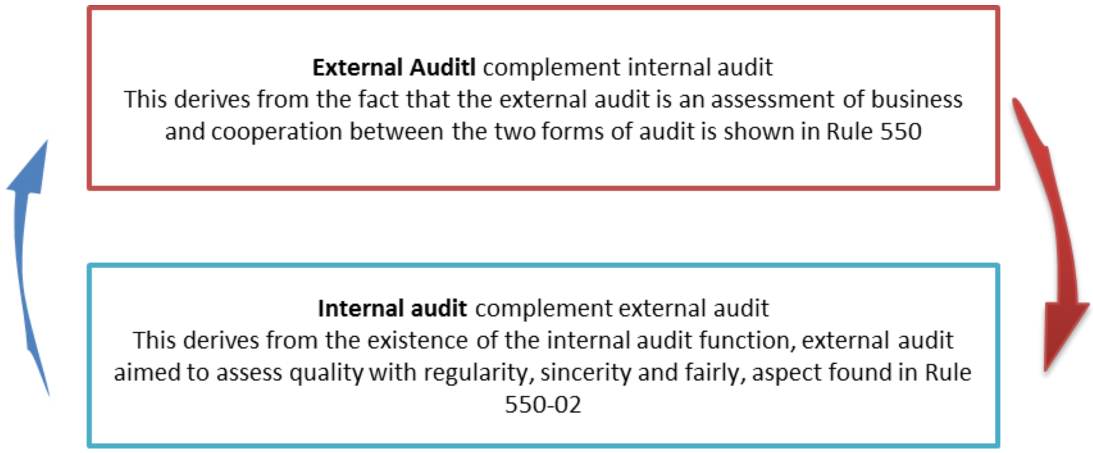
Comparison criteria	**External audit**	**Internal audit**
Auditor's position	▪ The external auditor can be an auditing firm or an independent person that is certified to conduct auditing services	▪ The internal auditor is employee of the entity
Addressability	▪ The external auditor address to shareholders, banks, regulatory authorities, clients and suppliers	▪ The internal audit address to managers, general direction or to audit committee
Purpose	▪ The external audit aims to check the annual financial statements, if they were framed according to legal requirements (regularity, fairness, accurate and correct picture)	▪ The internal audit aims to check the way business practices allow risk management and strategic objectives meeting
Field of application	▪ External audit looks at all entity's functions and compresses everything that affects the result and the preparation of financial statements	▪ The internal audit has a larger area where is applied than external audit and includes all entity's function considering their whole dimension
Fraud prevention	▪ External audit takes into account each fraud that can impact the results	▪ The internal audit takes into account all frauds that affect internal management of entity's functions
Audit agenda	▪ External auditor agenda derives his independence as he has a liberal profession. Thus, he decides on his own working program considering the assessment of risk accounts	▪ Internal auditor agenda comes from his status as an employee person, and his working schedule is based on an internal plan for checking the risk and the goals of the entity
The frequency of audits	▪ The external audit is intermittent and certifies annual financial statements and in relational terms is permanent	▪ Internal audit has a permanent character, which is planned, as it is part of one of the entity's functions. In relational terms it is periodically done
Methods and Procedures	▪ The external auditors applied standardized methods and procedures that can offer practical information, especially based on analyses and inventory	▪ The internal auditors use original and specific methods that are adjusted to the field where the company belongs to. The accountings methods are own created.

Source: adapted after Jaques Renard, Théorie et pratique de l'audit interne, Éditions d'Organisation, 7' édition, 2010, p.79-83

The most interesting difference highlighted by Hisham Sorour is the one that looks at the system of standards which one form of audit or another refers. The difference is presented in table 1 is the one regarding the methods and the procedures that are used. Its meaning is related with the fact that both audit forms have specific regulations. As a fact, it had to be mentioned that:

- From the accounting perspective, the external audit has to comply with the International Financial Reporting standards (IFRS) and from the way the auditing activity is conducted it has to consider The International Standards of Auditing (ISA);
- It is essential, that some countries (such as the Republic of Moldavia) have local internal auditing standards, while others, such as Romania and Iraq do not have local internal auditing standards. Instead, for the implementation of best practices Standards developed by the Institute of Internal Auditors (IIA) are used. Among them, other standards are also used which are issued vy international organizations such as the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

Even though Table no. 1 provides evidence on severely differences between external and internal audit, a bi-univocal complementarity between them is founded, which sometimes makes them inseparable. These features are presented in Figure 2.



Source: authors' own research

Figure 2. ***The complementarity of external and internal audit***

Both forms of audit have some similarities regarding the testing procedures, the system of internal control, the applied standards, the system of cooperation and reporting which **generate the conclusion** that both are deeply involved in the information system as a major element of managerial control.

No matter what the dictionary where the definition of audit is look at is, we observe that it is used as control, analysis and diagnostic. In other words, it is a fairly broad term due to which we misunderstand it as assessment, inspection or control.

We state this as, on one hand, there is not an auditor function rather financial auditor, internal auditor, quality auditor technical auditor, etc. On the other hand, even though we presented the difference between internal and external audit, we frequently misunderstand one way or another rof audit because of misleading elements that determine the semantics or the meaning of the word.

If we consider the internal audit, we have to deal with the fact that this collocation looks at assessing the way business practices allow for risk management and for achievement of the strategic goals, not because it is internally done (it could also be externalized). On the other hand, the external audit has this label not because it is externally done (most often) rather because it checks the annual financial statements to be prepared in accordance with legal requirements. Considering these, the financial audit can be seen as an assessment of financial features from which the label of financial audit comes.

As a fact, the audit term viewed independently it is an action defined with or without meaning that represents a replacement of the assessing and controlling terms.

3. THE IMPLICATIONS OF CORPORATIVE GOVERNMENTS CODES UPON THE AUDITING FUNCTION

In 1990 we find the first signs of corporate governance in Europe, namely the Cadbury Report (UK) becoming the first corporate governance code in Jan. 1992. At Europeean level, the OECD report is the mainstay of corporate governance, for it mentiones the six principles situated at the base of an effective corporative governance: ensuring an effective framework of corporate governance, shareholders' rights and their basic functions, fair treatment of all shareholders, the role of other stakeholders in corporate governance, providing information and transparency, management responsibilities (OECD, 2004).

For a better supervision of how companies have acquired the responsibility to respect the principles of corporate governance, the European area raised into discussion the "Comply or explain" statement through which they requires companies to express their reasons for their lack of compliance with the applicable provisions of the corporate governance. It is observed that corporate governance is thus at the same level of importance as the certification of financial statements by the management.

In addition to the corporate governance guide, "Comply or explain" should be included permanently on the companies' site (Horak & Bodiroga-Vukobrat, 2011), but this is not strongly regulated. If corporate governance codes are adopted at national level, the European Directive 46/2006 promotes their application by requiring that listed companies refer to the applicable provisions of the code when giving the statement on corporate governance. Even if the "Comply or Explain" statement is available to the interested parties, due to the existing corporate governance codes in each state, it is difficult to compare the information presented because every company is related to their working applicable state code.

The legislation also provides a standard format for the statement, which is why most times the explanations are not very informative (Sorensen 2009). The reforms of accounting and auditing profession are debating for several years, this reform of auditing standards and audit profession was motivated by the fact that, as things developed from the financial economic crisis, in the last decade, a number of shortcomings have been highlighted in the economic systems' financial stability. Audit reforms are consequences of scandals and large corporations collapse such as Enron, WorldCom, Lehman Brothers or Barings Bank.

One of the basic requirements for an effective capital markets is an effective and efficient audit, thus it is very important to obtain a true and fair view on the financial and non financial position and performance but also the changes during a financial year. This image can be rendered faithfully following a structured methodological approach in successive stages and well defined processes. During these stages, the financial auditor assigns a significant attention to the possibility of an entity to respect the assumption of business continuity (Martens et al., 2008).

By accessing the website of the European Corporate Governance Institute, it can easily be observed how often corporate governance codes were revised. Thus, Estonia highlights, for the state issued a single corporate governance code in 2006, still valid today, followed by countries such as Bulgaria, Croatia, Latvia, Lithuania, Romania and Slovakia, where in time only two corporate governance codes were presented.

At the other extreme is UK in the period 1992-2014 that has been subject to the 36 corporate governance codes, followed by Germany with 17 codes issued during the period 1998-2014, France with 13 codes issued between 1995-2013 and Denmark with 12 codes issued in the 2000-2014 period. By averaging the number of issued corporate governance codes in the 28 Member States of the European Union, will obtain the value seven, namely, each state would have about 7 corporate governance codes reviewed during 1992-2015. We notice a reduced frequency of corporate governance codes review in the Eastern European countries, which raised the first codes after 2000.

Following the analysis at EU level can see that all 28 Member States have adopted national corporate governance codes, mostly based on the "Comply or Explain" declaration, which involves taking a responsibility from companies to observe the provisions included in these codes, or being forced to state their reasons for which they have strayed from the law.

It is also noted the high interest of the States Member as regards the review of corporate governance codes. Spain is the only EU country that has reviewed the corporate governance code this year. During 2014, five countries have modified their corporate governance code applicable, as regards Denmark, Germany, Italy, Malta and Portugal, the latter by failing available to users in English, only in Portuguese.

Regarding the external auditor's independence (or statutory depends on expression used), entries in all corporate governance codes were found, except the Netherlands, Sweden and Poland. In case for Netherlands the only indication is the need for an independent internal audit. The most complex provisions on the independence of the external auditor are:

- In Austria, the auditor must ensure he does not have any business relationship with the entity (eg: consulting agreements) relationship that constitutes a threat to independence. The auditor is not allowed to occupy a management position in the company audited over the next two years after signing the audit report, and if intervening factors that might affect the independence and impartiality, it has the responsibility to immediately inform the President of the Supervisory Board respectively chairman of the Audit Committee;
- In Belgium, the external auditor must annually confirm in writing to the Audit

Committee to ensure the criteria of independence from the company and provide information on the existence of additional services provided to the company, outside the statutory audit, if necessary. At the same time, the external auditor must examine together with the members of the Audit Committee risks that could threaten independence, and analyzed the necessary measures to be taken to reduce such risks;

- In the case of Cyprus, the statutory auditors are prohibited from providing internal audit services to the same companies, not their independence and objectivity;
- In Italy, if a statutory auditor has an interest, direct or indirect, in a transaction carried out by the company concerned, it should inform management concerning the nature, terms, origin and extent of the interest held;
- In Hungary, before the appointment of an auditor by the Audit Committee / Supervisory Board, the candidate must give a written declaration stating whether a contractual relationship with the company in the last 3 years, or if there is a contractual relationship for year following;
- In Croatia, criteria of independence must be respected, as an external auditor is considered independent if he has any interest in the company and does not provide itself or through other persons, other services audited company.

Another aspect found in the corporate governance codes would be the rotation of external auditors. In this regard, there are specific mentions in governance codes of the following countries: Bulgaria, Finland, Lithuania, Luxembourg, Romania, Portugal, Slovakia and Slovenia. In Finland, when choosing an auditor should consider during consecutive audits, which may not exceed seven years; this rule refers to the auditor with main responsibility, not the audit firm to which he belongs. In Portugal, it is recommended rotation of auditors after two-three missions during three to four consecutive years. Ignoring this aspect should be explained by the Supervisory Board. For Slovenia, at least every five years will be a partner in change audit firm with which the company cooperates either will turn to another audit firm.

In the corporate governance codes in Belgium, Germany and Hungary there are provisions to the mission of an external auditor that shall be done before starting to make a statement written by the entity's management to ensure that it meets the criteria of independence. Also governance codes contain mentions to enable the auditor to supply non-audit services, but it is necessary to monitor the nature and extent thereof so that auditor independence is not impaired (Belgium, Estonia, Greece, Lithuania, Malta, UK).

In most cases, the body responsible for ensuring the independence of the external auditor is the Audit Committee or the Supervisory Board.

Regarding the external auditor's role, he has to draw up an audit report of financial statements in conformity with the law. For Austria, the auditor will also perform a report that will highlight the risks affecting the company and will present the report to the Board of Directors. In Belgium, among the duties of the statutory auditor's he must also comment the annual report of the management and check if it is "consistent" with the company's financial statements.

The French governance code mentions the obligation of the statutory auditor to inform the Audit Committee of any deficiencies identified at the internal control level.

In Portugal, the external auditor must verify the implementation of remuneration policies, efficiency and effectiveness of internal control mechanisms and report any deficiencies noted Supervisory Board. Not least in Sweden, the statutory auditor has the opportunity to review the existing accounting policies in the company.

Selection of external auditors (statutory) is a task performed by the Audit Committee that will submit proposals to the Board of Directors or Supervisory Board (depending on system management), the final decision belonging to the meeting of General Shareholders.

In countries such as Latvia, Ireland, Poland and Netherlands sufficient information on this aspect were not identified. In Finland, the shareholders along with the Audit Committee propose candidates for the position of external auditor. The corporate governance code of Great Britain stated that if the Board of Directors does not accept the proposal of the Audit Committee the Annual Report must contain the explained reasons why the Board of Directors rejected the proposal, namely the reasons that led to that proposal.

4. CONCLUSION

Reactions number of increasingly large financial scandals in recent years, caused by errors and especially frauds financial accounting, leading to awareness and the significant increase of interest in representing the audit as the main instrument of corporate governance. The role of an auditor is not to predict the future, but to give assurance that the companies' financial statements provide a fair picture of performance as highlighted by L.J. Lindley, L.J. Lopes and L.J. Kay, the auditors have similar roles like "watchdogs" and not that of "hounds". Therefore, the auditor cannot be liable for any wrongdoing that the leaders of a company can produce and for which there was no doubt that it would have occurred.

Therefore, the role of auditors is to determine if a firm's financial statements are free from any material misstatement, whether the information is true and relevant. We can draw clearly that the terms audit, inspection and cannot be mistaken chair if converge on the same goal.

Good corporate governance is nowadays considered the element that defends the interests of all parties involved, in one way or another, in a company's' proceedings, weather management, execution, or funding. All definitions of this concept lead to the idea of cooperation between management and shareholders, thus the being eternal conflict that the managers do not protect sufficiently the shareholders' interests, is removed.

To regulate corporative governance, codes of good practice were issued that provide companies with reference points regarding the design of organizational structures, their relationships, characteristics of those in charged with governance, financial reporting, etc.

Most codes of corporate governance are based on the "Comply or explain" declaration, their main feature being represented by flexibility. Thus, if there are plausible reasons for non-compliance with the provisions of the applicable corporate governance Code, the company in question will include/attach a statement in the annual report which will illustrate non-compliance reasons.

As we already mentioned, the corporate governance codes include provisions on organizational structures and relationships between them. Information on internal control, internal audit, financial audit, risk management, etc., should be included.

Since the image and reputation of a company are important elements, the financial statements' certification is required, thus, assuring the users of the reality and accuracy of the information. This is where the financial auditor's work intervene its role cannot be neglected in order to obtain a good corporate governance.

From a conceptual approach of the audit reporting, we have captured the most important issues, fixed by the standards and regulations in this area. Next, we examined the literature in the field by consulting the literature in the field of audit reporting.

We believe that reaching an audit function in the context of effective corporate governance is based on two levels and six defining elements. Thus, we believe that internal plateau is represented by four elements: internal control, board of directors, risk management and financial reporting while external plateau is represented by three elements: the external auditor's opinion, the investor confidence and transparency of information. By streamlining the interaction of these seven elements, each element contributes to the efficiency of the audit function in the context of corporate governance.

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