The quality of independent auditor’s report – does the size matter? The Romanian case

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Abstract

This study aims to show that, beyond any doubt, there is a link between the size of the auditor and the quality of the auditor’s report he issues. We have selected the Romanian listed companies and analyzed first their auditor and then the content and layout of the auditor’s report in order to see if, at least with regard to respecting the content imposed by International Standards on Auditing, the auditor respects the requirement imposed by - already old – auditing standards. The companies we performed the research on are all listed company on the Romanian Bucharest Stock Exchange in the first category. All those companies were required by law to audit their financial statements. By applying a qualitative method of research we have examined all the published auditor’s reports for the years 2011-2013 and compared them with the requirements of the ISA’s in order to see if the content and layout of the paragraphs is are compliant. Our results show that in case of small auditors, the quality of the auditor’s report suffers.

Keywords: audit report, audit quality, Romanian listed companies, financial statement

Introduction

This study aims to show that, beyond any doubt, there is a link between the size of the auditor and the quality of the auditor’s report he issues. The idea which is at the bottom of this article was generated by the increasing number of authors publishing on audit quality but without any reference of the format of the independent auditor’s report. Perhaps in the heart of the action was the International Federation of Accountants which released the project aiming to define and measure audit quality. More than that, their ambition is to identify the key elements that create an environment for audit quality. As such, subjects as the link between the audit quality and the size of the audit company was frequent between researchers from which we name DeAngelo (1981), subjects as defining the audit quality and the determinants for it were discussed on many journals by authors among which we mention Francis (2004), Deis, and Giroux (1992) and others. But even if the message of the audit report was considered important, even if the definition of audit quality included the audit report, we were not able to identify a study on the quality of audit reports with regards to their shape.

Research design

In order to analyze if there is a connection between the audit company’s size and the compliance with the ISA with regards to the content and layout of the auditor’s report, we have selected the Romanian listed companies and analyzed first their auditor and then the content and layout of the auditor’s report in order to see if, at least with regard to respecting the content imposed by International Standards on Auditing, the auditor respects the requirement imposed by - already old – auditing standards. The companies we performed the research on are all listed company on the Romanian Bucharest Stock Exchange in the first category (presently the categories changed). All those companies were required by law to audit their financial statements. By applying a qualitative method of research we have examined all the published
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The two companies which were not Romanian companies were removed from the population. In 2013 and 2012 there were 82 companies for which we were able to identify audit reports. For 2011 only 79 audit reports were identified. For three companies we were unable to find published financial statements (and accordingly, the auditor’s reports) after more than reasonable efforts.

For all the audit reports we have classified auditors in 3 groups. The first one is the one grouping large international companies – comprising both big four and all subsidiaries of companies which are ranked in TOP 40 international networks, association and alliances by Accountancy Age. Local companies are the second class and this group stands for other Romanian audit companies, affiliated or not to an international network (but not one from the Top 40 list). The third class is made of auditors registered as sole traders, as in Romania it is possible to audit listed companies if an auditor is registered as a sole trader, and the shock was that a significant percent of listed companies were audited by such auditors. Berinde (2013) used also a three class system to classify auditors however, he defined the classes as Big Four auditors, Non-Big Four auditors and auditors that work independently, in the form of accredited individuals, organized into private professional practices. The international literature usually uses two classes of auditors which refer to Big four and Non Big four audit companies. We consider our classification more adequate as, usually, when a company belongs to an international network it imports the entire quality assurance procedures amount which the one referring to the content and layout of the auditor’s report is to be found. Keeping that in mind, from the second class we have manually removed the audit companies which were part of an international network, even if not in the first 40.

Results
First of all, the study showed us the market structure when it comes to the type of auditor involved. Contradicting most of the studies previously published; on the Romanian audit market Big 4 companies are not the leaders when it comes to the number of audited companies. We underline that we had no data available to analyze the market share based on the turnover. As presented in Table 1.1 private individuals have a significant share of the market when it comes to audited companies.

<table>
<thead>
<tr>
<th>Category \ year</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 International Top 40 networks</td>
<td>19.05</td>
<td>20.00</td>
<td>20.51</td>
</tr>
<tr>
<td>2 Other companies</td>
<td>64.29</td>
<td>62.50</td>
<td>58.97</td>
</tr>
<tr>
<td>3 Private individuals</td>
<td>16.67</td>
<td>17.50</td>
<td>20.51</td>
</tr>
<tr>
<td></td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
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Source: Own projection

After identifying the local companies and individual performing audits on listing companies, we analyzed the wording and the layout in their reports. As expected, all the companies belonging to international networks proved they have respected the layout, the wording and the structure of the audit reports as presented by ISAs (International Standards on Auditing). On the other hand, even if most of the local audit companies were compliant with the same requirements, many of the audit reports were misstated. Such reports belong 100% to local audit companies and private individuals. We did not analyze if the grounds for changing the opinion or audit reports were adequate but we analyzed if the paragraph required by ISA are to be found and if they are in the proper order, if there are only allowed information
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included in the report, if the paragraphs are labeled and follow the structure in ISA, if they are signed and clearly written.

We imagine that audit companies belonging to international networks will follow the requirements when it comes to reporting as we also considered them as being more “equipped” to act as auditors on capital market due to some advantages that local company do not have. First, they have the knowledge and resources shared by their network, they have a better quality control system (which is also imposed by the network they belong to) and, secondly and very important, for multinational groups, as long as the parent of one company is audited by an auditor belonging to the network, it is more likely for subsidiaries to also be audited by local auditors belonging to that network.

Our results show us that a significant number of local auditors, also specifically private individuals, have included in the report matters not specified (and not allowed) by the standards. As expected, as long as the auditor was not changed by the company, the same mistakes are to be found from one year to another. The most common mistakes we identified were: inclusion of information not necessarily in the audit reports, such as, a mention to the number of audit contract, a reference to the trial balance audited, a detailed financial analyses of the financial statements performed by the auditor or even a specific matter that the corporate income tax form filled by the company was audited. Not labeling the paragraphs or not respecting the order of the paragraphs tends to be a common mistake. Unfortunately the quality of Romanian language was poor and typing mistakes were pretty common among some audit reports. audit reports counting more than 4 pages were not that rare.

The question comes: when someone sees that and report, should I conclude the audit was not performing to the required quality? Well, such a report does not prove that financial statements are misstated or that the auditor didn’t perform all the required audit procedures to assure that financial statements are free from material misstatements. However, we can conclude that the audit quality was poor as long as the auditor, in order to perform an audit of a desire quality should follow the standards. By making reference to un-needed information, by including un-necessarily information o the face of the audit report, the usefulness of this one is lost.

Conclusions

DeAngelo (1981) was among the first to promote the idea that audit quality is not independent of the auditor’s size. Our study, in line with his results, shows us that are more likely for a small local audit company or individual not to issue an audit report respecting the requirement of ISAs. It does not mean the financial statements of the client are materially misstated, it only means that the auditor, even when it was about such a non-costly requirement, was not able to follow the ISA. Can we say the quality of such missions was not as expected? We can, as the first step to assure quality should be the apply the requirements. Another important question that raises, which is not investigated in oru reaserch, is the audit committee was not ale to identify the por quality of the audit reports?

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