

Theoretical Considerations on the Influence of the Auditor's Independence on Audit Quality

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Abstract

Although no method has been found yet to guarantee the optimum quality level for the financial information users, and implicitly the quality of accounting and audit services, the efforts concerning these aspects have lately intensified, and a multitude of elements that influence quality in audit and the accounting profession are analyzed and interpreted by many authors. In our research, we aim to analyze the manner in which ethical and moral principles, especially the auditor's independence, may influence the quality of audit. The purpose of this paper is to stress the connection between ethical principles, responsibility and quality in accounting.

Keywords: ethical principles, the auditor's independence, audit quality, professional responsibility

Introduction

Without being too exhaustive in our approach, we can state that this feature of financial-accounting information, *quality*, dominates the world of accounting and audit services, and it is at the same time controversial as well delicate and necessary. Moreover, we consider the quality of the accounting/audit profession to be one of the essential conditions that lie at the basis of quality financial reporting and implicitly of a favorable approach from an economical perspective.

The need and importance of ethical, professional and personal behavior norms come both from the important role played by freelance accountants towards the state and society, and from the essential requirement of service quality, based on science, competence and conscience, independence in spirit and lack of material interest, morality, probity, dignity and professional behavior.

The lack of ethical and moral principles in accounting and audit would create the premises for “*legal fraud*”, which are not necessarily dependent on creativity, but rather on the weakness of an accounting system lacking ethical norms and principles, in short, lacking quality. Under these circumstances, if we refer to the importance of ethics in accounting, without becoming overly exhaustive in our approach, we could state that the purpose of their occurrence was to guide economic life. As a result, the Machiavellian slogan “*the end justifies the means*” is out of place in the world of transactions, in a moral economic competition. We subscribe to the opinion that the truth that accounting attempts to build as a true and fair view is one of the virtues that ethics, morality, and religion cultivate as a priority (Horomnea E., 2012). Specifically, accounting observes, records, quantifies, processes, and communicates specialized information to a well determined market: internal and external users.

Without the compliance with moral principles and norms, contemporary world is subject to chaos. Therefore, in the current economic context, *the mission of the accounting professional has crossed the borders of a simple job* and has come to mean *the guarantee of the correctness of the public information* provided by economic entities.

Material and Methods

In our approach, the dominant research stream is the *positivistic* one, aiming to explain, through a detailed and advanced approach, the various sides of the effects of ethical principles on quality in audit and the accounting profession, in the conditions of performing a responsible and quality audit activity.

This paper comprises elements of the *interpretative and critical streams*, as various norms, regulations and practices in the field will be discussed in an interpretative manner (a neutral point of view is adopted), as well as critical one (involvement in a particular viewpoint). The research will be fundamental and its purpose will be a theoretical

generalization after noticing the insufficiency of knowledge in respect to the *importance and need to apply ethical principles, quality and responsibility in audit and accounting*, as well as identifying certain facts, for which theorization was not suggested.

Literature review

Accounting and the accounting professional resort to virtues such as: justice, prudence, probity, dignity and the professional deontology of the accounting expert is concentrated in the slogan "*Science, Independence, Morality*". The correlation between ethical principles and those of the "science of accounts" comes from the fact that any deliberate alteration of the truth is a forgery of reality, an abdication from ethical and moral principles.

According to Arens and Loebecke (2004), there are several methods through which the accounting profession and society as a whole encourage auditors and accounting professionals to behave appropriately and provide high quality financial-accounting and audit activities, like: *quality control, continuous training demands, legal liability, peer evaluation, the professional behavior code and exams for accessing the profession*.

Ethics can be defined as a set of principles that give value to morality. Ethical behavior is necessary for a society to work in an orderly manner. Moreover, the need for ethics is important enough for various moral values to be included in laws. The AICPA professional behavior code provides both, general norms for an ideal behavior and specific behavioral norms, with concrete application.

At an international level, **IFAC** (*the International Federation of Accountants*) adopted *the international ethical code of accounting professionals*. In the opinion of Horomnea E. (2011), the need for the Ethical Code comes from: insuring optimal quality; preserving public trust in this profession; attracting and preserving the customers of audit services; validation of the work performed by accounting professionals; insuring protection for the financial auditor and for the users of audit services; defending the honor and independence of the accounting professionals and of the body they are part of.

The main representative of the free accounting profession in Romania is *The Body of Accounting Experts and Certified Accountants of Romania*. With over 90 years of activity, it was involved not only in the practical regulation of the financial-accounting activity, but *has also*

constantly promoted the ethical side of the accounting profession. Also, as a member of the International Federation of Accountants (IFAC), it permanently contributes to meet the objectives of developing and promoting the accounting profession, coordinated at the world level with harmonized standards. A necessity of the past as well as of the present, created with the purpose of improving the uniformity level of professional ethics and to establish behavioral norms for all the accounting experts in Romania, *The national ethics code of the accounting professionals*, compulsory since January 01, 2007, formulates the fundamental principles that must be applied and complied with by all professionals, and especially by all members of the Body, in order to achieve the common objectives, according to the *International Ethics Code* issued by the world accounting body, IFAC. Moreover, *the new National Ethics Code of the Accounting Professionals*, approved by the *Decision of the High Council of the Body of Accounting Experts and Certified Accountants in Romania, no. 11/216 of March 31, 2011*, based on the Decision of the National Conference of the accounting experts and certified accountants no. 10/65 of September 2, 2010, is compulsory for all CECCAR members in accomplishing the professional services in Romania, starting with January 01, 2011.

Also, *the Chamber of Financial Auditors in Romania* adopts in its entirety *the Ethical Code of Accounting Experts, issued by the International Federation of Accountants (IFAC)*, version July 2009.

The impact of the auditor's independence on the quality of the financial-accounting information published

All professions, irrespective of the field they belong to, are governed by rules, standards and principles that must be complied in good conditions. According to Popa, Tiron, Tudor (2012), because of the peculiar and confidential nature of many services, as well as of the need of the beneficiaries to be able to trust them, professionals are subjects of technical, ethical and moral rules.

As we mentioned in the previous section, in a modern society, a distinctive feature of the accounting profession consists in establishing and acquiring a *professional deontology code*, which stipulates the exact optimum level of the behavior necessary for each accounting professional, since he joins the profession. For this reason, each accounting expert/auditor in Romania is *responsible* to comply with the

national ethical code of the profession. An accounting professional must analyze any threat of the ethical principles, or simply to guess the circumstances and relations that may endanger his principles, especially his independence (Spalding, Alfonso, 2011).

The auditors' independence is an essential attribute that must be taken into account when speaking about the quality in audit. Regulations should be concerned with informational asymmetry and conflicts of interests in relation to quality in audit. These types of relations appear as long as we are dealing with at least three contractual parties involved, respectively: the clients, the auditors and the users, everyone having their needs. In this respect, the auditor's independence is an essential attribute that must be met for the successful performance of the activity.

In audit, independence means adopting a neutral viewpoint in performing the audit activity. The auditor must preserve his independent attitude while performing their duties and the users' trust is equally important in the auditor's independence. The previously mentioned situations are called factual independence and apparent independence. According to Arens and Loebecke (2004), *factual independence* means that the auditor can actually preserve an objective attitude all along the audit mission, while *apparent independence* is the result of interpretations made by other people. In other words, it is not enough for an auditor to consider himself independent, this attitude has to be perceived by all the external users and should not be questioned.

First of all, the role played by audit in contracts with third parties appears when independence applies. In problematic cases, the third parties that close a contract with the auditor base their decision on the trust that the respective auditor offers, provided that independence is respected. In an opposite situation, when an auditor does not comply with the principle of independence, many economic activities are endangered by deceiving audit. The contractor is not the most affected party when the legal system imposes strictly professional liability from the auditor, because other clients of the audited company will be affected (Bédard, 2006).

D. Prawitt, J. Smith and D. Wood (2012) argue that, in case it is assumed that the auditors provide a uniform level of quality in the performed activity (especially when it comes to independence), clients who require a certification of the reflection of their company's economic reality, to prove them a good financial situation, will see their

name associated to an auditor classified as lacking independence, thus minimizing the users' trust in the financial statements in which they exerted their profession. Moreover, the affected third parties may resort to legal competence bodies in order to obtain compensations for the denigration of the company's image because of the lack of independence of the auditor who verified the financial statements. They also benefit from the active support of professional organizations, as well as of supervision bodies, in order to repair the situation.

In a study, Collier and Gregory (1999) analyzed the relationship between the audit committee and agency-specific factors, including the quality of the auditor. They noticed that the activity of the audit committee increases in companies whose costs are higher. The quality of the activity performed by the auditor and the lever effect are tightly connected to the activity of the audit committee, being indirectly proportional with the degree of inclusion in the company of the people. *The authors recommend preserving the independence of the audit committee for increasing the quality of the auditors involved in audit missions, but they cannot guarantee if the improvement in the activity of the audit committee will insure performance.*

In the audit of financial statements, the auditor must apply a control methodology that insures his independent opinion, able to judge or defend equally all the users of the accounting information, all the actors participating in economic and social life, respectively the shareholders, the state, the employees, the banks, the third party debtors, the providers, etc. (Costuleanu et al., 2011).

Results and Discussion

In recent years, special accent has been placed on high quality practices in the accounting profession worldwide. Besides, there are numerous studies concerning *ethics*, confidentiality and professional behavior. It has been practically proven that, in the context of the evolution of the economic situation at the world level, as well as in our country, the financial auditor is the professional who can contribute in a significant extent at the healing of the economic climate and at the reestablishing of the confidence in business. *Through professionalism, independent attitude and transparency in performing audit mission, through drawing quality reports, in conformity with the international standards and with the ethical code of the profession, the auditor meets the public interest, fulfilling at the same time an important social role.*

Moreover, after verifying and certifying the information provided to the users by an ethical, competent and independent auditor, favorable conditions are created for (re)establishing the confidence between the producers and the users of the accounting information.

Conclusion

The accounting profession, like other professions, faces new challenges because of the continuous legislative changes, of the occurrence of new types of accounting/audit and insurance services, of the impact of the new information and communication technologies, of the increase in the number and quality of professional standards, of the appearance of new software products, of new reporting methods, etc. Moreover, the accounting profession must take responsibility for the public interest in providing high quality services, while complying with professional standards.

We conclude by stating that accounting professionals are actors on a market where the demand and offer of accounting information are confronted. They must be aware of the important role they have on this market, provide a fair view of the financial position and of the performance of the company, analyzed in the conditions of complying with the *ethics code* in completing the accounting act and taking responsibility in the performed activity. A good professional nowadays knows what the Romanian accounting reform means, learns to understand and apply the International Standards of Financial Reporting, as well as the International Audit Standards, is aware of the importance and scope of the application of professional reasoning, counsils the company management in supporting accounting policies, is subject to the *Professional ethics code*, being aware of the limitations of his judgments. He must acquire knowledge and use professional reasoning correctly. Finally, competence comes first, together with *responsibility*. Considering these aspects, there is an obvious connection between: the importance of fundamental ethical principles, the impact of the auditor's independence on the quality of financial-accounting information published, *responsibility and quality in the accounting profession*.

Acknowledgements: This work was partially supported by the European Social Fund in Romania, under the responsibility of the Managing Authority for the Sectorial Operational Programme for

Human Resources Development 2007-2013 (grant POSDRU/CPP 107/DMI 1.5/S/78342/2010).

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