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THE ROLE OF THE STATUTORY AUDIT IN ENSURING THE QUALITY OF FINANCIAL INFORMATION

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Abstract: Statutory audit provides independent assurance that the financial statements of entities such as correctly reflect their situation. Experience in many countries has shown that insufficient attention being paid proper role of statutory audit in the process of restructuring and modernization creates vulnerability and may lead to financial scandals, financial crises and long-term damage to the capital markets and lending. The role of statutory audit in the context of restructuring and modernization of the economy is reflected in ensuring the reliability of financial information reported by various entities. There can be no doubt that a reliable information enhances the confidence of investors and creditors, particularly important in this context.

A good regulation of the statutory audit strengthens the confidence of investors and creditors, which is particularly important in the financial markets. Effective, investigative and independent oversight of the audit activity is vital in this context. The transposition of the audit directive and the Regulation on the specific requirements for the audit of entities of public interest provides an opportunity to improve the regulatory framework for audit activity and public supervision. The investigation used the qualitative research method and the observation technique based on the analysis of national and international normative acts. The results indicate a good harmonization of the regulatory framework of the financial audit activity in the Republic of Moldova with the international practices in this field.

In order to better align with the provisions of the audit directive, the incorporation of some regulatory aspects of the statutory audit activity into the national legislation would be welcome. In order to exercise the public supervision of the audit activity, it is necessary to restructure and modernize the system, namely the creation of the Agency for the public supervision of the audit, which will be the only competent authority with final responsibility for the public supervision of the audit activity.

Keywords: audit activity, international auditing practices, financial statements, professional standards, public supervision.

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1 Introduction

Experience from many countries has shown that the role of statutory audit in the context of restructuring and modernization of the economy is to ensure the reliability of financial information reported by various entities. In the opinion of American researchers statutory audit provides independent assurance that the financial statements of the entities accurately reflect their financial position (Arens & Loebbecke, 2010).

Statutory audit is the activity of auditing the annual financial statements or consolidated financial statements for the purpose of expressing professional and independent opinion on the authenticity of the reported information. Statutory audit is performed by auditors who are certified and licensed for this type of activity.

Failure to give adequate attention to the role of statutory audit in a restructuring and modernization process creates vulnerability and can lead to financial scandals, financial crises, and long-term damage to capital and credit markets. That is why researchers in the field note that there can be no doubt that reliable information strengthens the confidence of investors and lenders, which is particularly important in the given context (Vanstraelen, A. et al. 2012).

The reliability of the financial and accounting information summarized in the financial statements is then validated by a professional accountant, who acts as auditor. He or she no longer applies the checks already carried out within the company, but carries out checks ranging in scope from assurance assignments to related services such as the compilation of financial statements.

The approach to financial auditing, in terms of the current need for information, should be carried out not only by means of global but also European standards. At present, within the European Union certain rules are applied, which regulate the audit of consolidated financial statements, as well as special requirements for identifying the professional qualification of the person who is entitled to be engaged for the exercise of statutory audit.

The Republic of Moldova has signed the Association Agreement with the European Union and has undertaken the commitment to comply with the provisions of Directive 2006/43/EC on statutory audit of financial statements and consolidated accounts, Regulation No. 537/2014 of the European Parliament and of the Council of April 16, 2014 on specific requirements for statutory audits of public-interest entities.

2 Results obtained and discussion

Since state audit by content is a form of economic control, at the macroeconomic level this activity is promoted by audit firms and at the microeconomic level it is represented by the audit committee. Unlike the other forms of state economic control, statutory audit activity is placed in the sphere of entrepreneurial activities.

Statutory audit according to ISA 200 presents an independent expert examination of financial statements by authorized persons for the purpose of determining their authenticity, completeness and compliance with the provisions of the normative and legislative acts regulating the keeping of accounts and preparation of financial statements, as well as other types of controls (ISA 200, para. 12).

Auditing can also be defined as the process of checking the entity's accounts for authenticity and fairness. The same conclusion has been reached by specialists in the field who consider that the statutory audit activity is a process through which a competent and independent worker accumulates and evaluates evidence about the information subject to qualitative appraisal and related to the peculiarities of the economic system, for the expression of the degree of compliance of this information with the predetermined criteria (Toumeh, A., et al. 2018).

Based on the definitions given to statutory audit, we can note the following directions of contemporary auditing adjacent to related services:

- audit of financial indicators of the entity or audit of financial statements;
- audit of management activities on the efficiency of the entity's asset management;

- organization and bookkeeping services, preparation of financial statements and tax returns;
- control of the entity's economic system based on accounting data.

The mentioned directorates have also appeared in the Republic of Moldova, but under the aspect of other concepts presented in Table 1. As a rule, external auditors provide independent certification of the veracity of financial statements. It should be noted that financial statements serve as a basic source of information for decision making by investors, creditors, suppliers, customers of the entity.

The correspondence audit is applied in the interests of the management, and the statutory audit is applied on the initiative of the owners of the entity. Therefore, it is considered that these audit functions must be carried out by different persons, in parallel or simultaneously, and usually independently. The compliance audit is usually carried out at the request of the entity's management by its own subdivision, empowered with such functions. While the audit of the financial statements and the statutory audit respectively come from the initiative of the owners and can be exercised by a third party on a contractual basis or according to the legislation in force, by the Censors Commission, as in the case of the Joint Stock Company.

Table 1 Common and specific features compliance and statutory audit

Criteria examined	Compliance audit	Statutory audit
Object analyzed	Economic and financial activities	Internal control policies and procedures
Purpose pursued	Analysis of the efficiency of economic and financial activities	Assessment of the adequacy and effectiveness of internal control systems
Beneficiaries	Management and owners of the economic agent	
Enforceable	Internal and external auditors	

Source: author own study or based on Hategan, C.D. et al. (2015)

This synthesis of the features allows us to ascertain the fact that the correspondence audit differs from the statutory one according to the object researched and the purpose pursued. However, both directorates have the same beneficiaries and executors. Notwithstanding the fact that the audit objectives can be achieved by both their own and external auditors, they know better all the details of each activity. Therefore, at the first attempt at synthesis, it would seem that the statutory or compliance audit is carried out more qualitatively by the entity's employees or by external auditors who have been auditing the same client for a long time.

However, since the statutory auditor is more experienced, auditing different entities, his recommendations regarding the methodology of improving the internal control system may be more successful than in the previous case. In other words, any analysis, any control, any verification and any study on a section or part of the accounting or financial statements of an entity can be qualified as a statutory audit task.

The public expects the statutory auditor to play a role in protecting its interests by providing reassurance on: the accuracy of financial statements, the continuity of operations and the solvency of the entity; the existence of fraud; the entity's compliance with its legal obligations; responsible behavior of the entity towards environmental and social issues.

Businesses large or small have to use the services of auditors or chartered accountants without always knowing who these professional accountants are, what they are and what they do.

Underlying the study of internal control and the assessment of control-related risk are three key concepts (Lowensohn, S. et al. 2007). According to the first concept, namely managerial responsibility, the responsibility for preparing the financial statements is borne by the management of the entity, but not by the auditors. Namely, the former must define and supervise the application of the entity's internal control procedures, while the auditor is only obliged to objectively express his opinion about the authenticity of the situation reflected in the financial reports.

The second concept is reasonable assurance. It follows from the recital that the entity must be permanently concerned with the efficiency of the internal control procedures, so that the latter provide reasonable assurance that the financial reports reflect the true and fair situation. Also, according to this concept, the company is not in a position to introduce an ideal internal control system, as its costs may be too high in relation to the benefits obtained from its commissioning. In many cases, it is more cost-effective to request the services of an audit firm or even the maintenance of an internal audit department, than to incur high expenses related to the existence of internal control.

For the audit of financial statements, the third key concept of internal control, namely inherent restrictions, is of the same interest. The authors of this concept state that internal control procedures cannot be considered perfectly effective, because if internal control employees will design an ideal system, then its effectiveness will depend on the professional competence of the people who will use it. In fact, the conception is fully true even from the following example. Material stocks are released from the warehouse to the production section only if the consumption limit sheet contains the signature of the chief engineer. This procedure can be easily avoided if there is a secret agreement between the depository and the head of the production section regarding the quantity released. As is known, in production it is practically impossible to find out exactly how much raw material is consumed. The veracity of the data reported to the accounting depends largely on the honesty of the persons materially responsible.

In the audit process, in order to achieve the overall objective, the auditor will obtain reasonable assurance on the financial reports if they do not contain material misstatements, as a result of fraud or error, and present a report of the financial statements in accordance with the auditor's conclusions. In all cases, where this objective has not been or cannot be achieved, the auditor shall be required to amend the corresponding audit opinion or withdraw its commitment. To this end, the auditor shall obtain sufficient and adequate audit evidence in the context of the achievement of the overall audit objective. However, even if the rules refer to more than one objective, one objective cannot be achieved individually and in this situation the auditor will consider the objective achieved if all the other objectives provided for by the same standard are achieved by the auditor (ISA 700, para. 7).

The opinion of the statutory auditor expresses the results of the substantive verification of the main elements of the financial statements. At present, however, in order for the opinion of the statutory auditor to provide assurance on financial information, the substantive verification is also accompanied by the risk-based approach. By means of testing techniques of accounting and internal control systems, statutory auditors try to minimize the risk of identifying material misstatements.

Any definition of statutory audit shall take into account the needs and expectations of users, to the extent that they are reasonable, as well as the ability of the statutory auditor to meet those needs and expectations.

Thus, if in the past the opinion of the statutory auditor was largely based on audit evidence obtained through substantive tests, nowadays in order to ensure its adequacy and sufficiency, it is necessary to carry out missions to assess significant risks and misstatements.

Thus, the objective of any type of audit is to improve the use of information. Not only for the statutory audit, the purpose of the audit is to express the opinion on the financial statements of the entity, but also in other situations specified above. From this point of view, we consider that the use of the term financial audit in local legislation instead of statutory audit used in European legislation creates confusion.

Statutory audit involves the examination by a competent and independent professional accountant of an entity's financial statements in order to express a reasoned opinion on the fair, clear and complete picture of its financial position and position as well as its results or performance.

In other words, the statutory audit is the financial audit carried out by statutory auditors who examine or verify, i.e. certify in their entirety the financial statements according to the audit rules, including taking into account activities and operations specific to the audited entity, by virtue of legal provisions as a result of the mandate received from the owners of the entity.

Table 2 Evolution of statutory audit

Statutory audit objectives	Character of the audit engagement		
	In the past	currently	Looking ahead
Background check of assets, liabilities, income and expenses	assessment	assessment	assessment
Assessment of significant risks and misstatements	aid	assessment	assessment
Appreciation of business decisions	counseling	aid	assessment

Source: author own study or based on Zhang, J. et al. (2017)

However, the current statutory audit cannot provide any other than reasonable assurance regarding the true and correct picture of the financial situation. The opinion of the statutory auditor ensures compliance with the financial reporting framework rather than a view of the entity's financial health.

The basic elements of the statutory audit concept are:

- the competent and independent professional who can be a natural person or a legal person;
- the object of the examination carried out by the professional accountant is the financial statements of the entity, in their entirety: balance sheet, profit and loss account and the other components of the financial statements, depending on the applicable accounting framework;
- purpose of the examination: to express a reasoned opinion on the fair, clear and complete picture of the financial position, financial position and results achieved by the audited entity;
- the quality criterion according to which the examination is made and the opinion is expressed is the auditing standards and accounting standards.

For expressing an opinion, those auditing standards recommend that the auditor use the phrases: "the financial statements present fairly, in all material respects" or "the financial statements give a fair and true and fair view", which are equivalent (ISA 700). And in order to ascertain the truthful and complete picture, the auditor must seek and accumulate sufficient and adequate evidence to substantiate the answers to the following questions regarding:

- the correspondence of the value of the property with the balance sheet data;

- the correspondence of the results of the economic and financial activities (profit or loss) with the data of the profit and loss statement;
- the size of the dividends;
- the real value of the receivables and the effective possibilities of repayment in the near future;
- the real value of the loans and the certainty in the absence of other debts not reflected in the balance sheet;
- the probability of bankruptcy of the entity.

Based on these answers, the beneficiaries of the audit report, being more confident in the authenticity of the financial statements, are more confident in making decisions about making investments, granting loans, supplying raw materials, etc.

The effectiveness of control procedures depends to a large extent on the environment in which internal control operates. The control environment is a basic component of internal control, which is related to the attitude of the management and members of the board of directors towards the need for effective internal control within the entity. The control environment influences the effectiveness of certain control procedures. For example, a strong control environment, such as one with strict budgetary control and an effective internal audit service, can considerably complement certain control procedures. Factors that determine the control environment would include:

- the functions of the board of directors and its committees;
- management philosophy and leadership style;
- the organizational structure of the entity and the method of establishing powers of attorney and responsibility;
- the management control system, including the internal audit service, the policy and procedures related to the staff, as well as the division of responsibilities.

There are other important factors that determine the control environment. For example, the effectiveness of this type of control depends very much on the professional and individual qualities of the internal control staff. Among the individual qualities of auditors and internal controllers - sincerity (honesty) is the most important trait of the employed person. Honesty, according to the Code of Ethics for Professional Accountants, involves not only professionalism, but also sincerity. Objectivity, in turn, requires auditors and accountants to be fair, intellectually honest and not involved in conflicts of interest.

Statutory auditors must provide assurance that financial reports reflect the effect of fraud and that all necessary details are declared. So, the public expects the possibilities of fraud to be minimized. The management must take measures to organize and maintain the internal control systems that reduce the chances of fraud. Thus, statutory auditors must confirm in the audit report that such internal control exists and mention whether it exists and works.

Conflicts of interest in the appointment of the statutory auditor would disappear if this responsibility were assigned to the owners or a third party. It is also logical for the appointment to be made by auction and to be the responsibility of shareholders, investors, other parties with commitments and interests in the business of the audited entity but not in the responsibility of management.

Participation in the regional process, reshaped by the enlargement of the European Union, involves the development of a series of very important internal events, which also aim at the adoption by the Republic of Moldova of an effective set of rules and practices in various fields, including regarding statutory auditing. In order to achieve these objectives, the Republic of Moldova is to ensure the resolution of problems related to statutory auditing and quality assurance for statutory auditors and audit firms auditing public interest entities.

In the European Union, Regulation No 537/2014 and the revised Audit Directive have considerable implications for the structure of the existing audit framework. Thus, a regime is established under which a single competent authority must be designated with final responsibility for all regulatory tasks related to statutory audit. At the same time, the State may delegate to other authorities some supervisory and quality assurance tasks, subject to supervision by a competent statutory audit authority.

Regulatory and supervisory bodies, such as the Audit Supervisory Board, the National Bank of Moldova and the National Commission for Financial Markets, will continue to play an active role in strengthening efforts in implementing regulations in the field of statutory audit. Therefore, it is proposed that these bodies engage in an awareness-raising dialogue on the benefits of strengthening existing financial reporting and auditing practices in all public-interest entities, including significant state-owned enterprises.

In order to ensure the independence of the auditor and the objectivity of the audit opinion, it is necessary to prohibit the provision of non-audit services. The services, which cannot be performed simultaneously with the audit of the financial statements for the period from the beginning of the audited period until the issuance of the auditor's report, are:

- tax services (preparation of tax returns, providing tax advice, on payroll taxes, customs duties, etc.);
- services involving participation in the management or decision-making process of the audited entity, bookkeeping services and preparation of financial statements;
- designing and implementing internal control or risk management procedures for the preparation and/or verification of financial information or information systems for financial information;
- legal services, in terms of providing general advice, negotiating on behalf of the audited entity and representation in dispute resolution procedures, services related to the internal audit function of the audited entity;
- services related to the financing, capital structure and modification, as well as the investment strategy of the audited entity, with the exception of the provision of insurance services such as the issuance of confirmation letters in relation to prospectuses issued by the audited entity.

3 Conclusions

The statutory audit has a significant role in maintaining efficient business relations as it is the key to supporting vibrant financial markets in the process of restructuring and modernizing the economy. The opinion of the statutory auditor expresses the results of the substantive verification of the main elements of the financial statements. At present, however, in order for the opinion of the statutory auditor to provide assurance on financial information, substantive verification needs to be linked to the risk-based approach.

Although the auditor's role is to ensure that financial reporting adequately reflects the needs of a wide range of financial information users, the current statutory audit cannot provide any assurance other than a reasonable one regarding the true and fair picture of the financial position. The opinion of the statutory auditor ensures compliance with the financial reporting framework rather than a view of the entity's financial health.

Good statutory audit regulation strengthens investor and creditor confidence, which is particularly important in financial markets. In this context, effective, investigative and independent oversight of audit work is vital. The transposition of the Audit Directive and the Regulation on specific requirements for the audit of public-interest entities provides an opportunity to improve the regulatory framework for audit and public oversight. In order to better align with the provisions of the Audit Directive, the incorporation of regulatory aspects of statutory audit activity into national legislation would be welcome.

This activity, first of all, must be supported by a legal framework that would provide the mechanism for managing conflicts of interest inherent in the current landscape of statutory auditing, such as: the issue of designation and determination of the size of the statutory auditor's fees; poor turnover of audit firms; the provision by audit firms of services that are not related to the respective field.

The problem of implementing an effective system of investigations and sanctions to detect, correct and prevent improper auditing of financial statements remains topical. It is also considered necessary to establish specific requirements for audits of public-interest entities, such as: restriction of fees, prohibition of the provision of non-audit services, inclusion of mission quality assessment requirements. Special provisions will apply to the appointment of the auditor and the duration of the engagement, the content of the auditor's report.

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