

Aspects Regarding the Statutory Audit of Non-Financial Entities Listed on the Bucharest Stock Exchange

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Abstract

According to the provisions of European and national legislation, the annual financial statements of companies whose securities are admitted to trading on a regulated market are subject to statutory audit.

The present study aims to evaluate the audit of the information entered during 2018-2020 in the annual financial statements issued by 30 non-financial entities listed at BSE (89 annual financial statements in total, one company being delisted in 2019). The purpose of this study is to identify whether the annual financial statements of the listed companies were accompanied by audit reports, how the audit reports complied with the requirements of international standards and national regulations and what differences and similarities are there between the respective audit reports.

The method used was quantitative and consisted in analyzing the data entered in the audit reports that accompanied the annual financial statements published on the BSE website.

The audit reports complied with the legal requirements, except in some cases, when in terms of similarities and differences, even though all reports contain in principle the same headings, differentiation was made by key audit issues.

Therefore, the study is addressed to authorities, audit firms and economic operators, who can use the results obtained, both in the regulatory activity and in the preparation of audit reports and their presentation in the financial statements.

Keywords: key audit aspects, audit report, annual financial statement, non-financial entities.

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Introduction

In the United States, following the financial scandals involving companies such as Enron in 2001, Adelphia, World Com in 2002, two Senate representatives (Sarbanes and Oxley) proposed and promoted the Sarbanes-Oxley Act in 2002, which was entitled "Public Company Accounting Reform and Shareholder Protection Law". The application of this law has led to financial reporting certificates being issued individually by senior management of entities and has increased the oversight role of boards of directors and the independence of external auditors who review the accuracy of corporate financial statements. Later, other states also considered that stricter financial governance laws were needed, with SOX-type regulations being adopted in Canada (2002), Germany (2002), South Africa (2002), France (2003), Australia (2004), India (2005), Japan (2006), Italy (2006), Israel and Turkey (Wikipedia - Sarbanes - Oxley Act)

In Europe, Fourth Council Directive 78/660 / EEC of 25 July 1978 on the annual accounts of certain types of companies and three other Directives (Seventh Council Directive 83/349 / EEC of 13 June 1983 on consolidated accounts, Council Directive 86/635 / EEC of 8 December 1986 on the annual accounts and consolidated accounts of banks and other financial institutions and Council Directive 91/674 / EEC of 19 December 1991 on the annual accounts and consolidated accounts of insurance undertakings), required the auditing of annual accounts or consolidated accounts by one or more persons authorized to carry out such audits.

The conditions for the authorization of the persons responsible for carrying out the statutory audit were laid down by the Eighth Council Directive 84/253 / EEC of 10 April 1984 on the authorization of the persons responsible for the statutory audit of accounting documents. The lack of a harmonized approach to statutory audit at Community level was the reason why the Commission proposed in its 1998 Communication on statutory audit in the European Union: a way forward, the creation of an Audit Committee that could develop future actions in close cooperation with the accounting profession and with the Member States. Based on the work of that committee, the Commission issued on 15 November 2000 a Recommendation on quality assurance for statutory audit in the European Union: minimum requirements and on 16 May 2002 a recommendation on the independence of statutory auditors in the EU: A set of fundamental principles.

With the publication of Directive 2006/43 / EC of 17 May 2006 on the statutory audit of annual accounts and consolidated accounts, which amended Directives 78/660 / EEC and 83/349 / EEC and repealed Directive 84/253 / EEC issued by the Council, the objective was to harmonize at high - though not full - level the requirements of legal audit. These refer to the qualifications obtained by statutory auditors under those directives which must be considered equivalent, to the fact that statutory audit requires adequate knowledge of issues such as company law, tax law and labor law.

As of April 2014, Regulation (EC) No 537/2014 of The European Parliament And Of The Council of 16 April 2014 on specific requirements relating to the statutory audit of public-interest entities, repealing Commission Decision 2005/909 / EC of public-interest entities, rules on the organization and selection of statutory auditors and audit firms applied by public-interest entities to promote their independence and avoid conflicts of interest, and rules on the supervision of compliance with these requirements by statutory auditors and audit firms. It also states that Union law provides that the financial statements, consisting of annual financial statements or consolidated financial statements, of credit institutions, insurance companies, issuers of securities admitted to trading on a regulated market, payment institutions, credit institutions collective investment schemes (UCITS), electronic money institutions and alternative investment funds are audited by one or more persons authorized to conduct such audits in accordance with Union law.

In Romania, the financial audit and the independent exercise of the profession of financial auditor were regulated by Emergency Ordinance no. 75 of June 1, 1999, amended by Law no. 167 of July 6, 2017 on the statutory audit of the annual financial statements and the consolidated annual financial statements. It stipulates that financial auditors and audit firms must perform the statutory audit in accordance with the international auditing standards adopted by the European Commission according to the provisions of art. 26 paragraph (3) of Directive 2006/43 / EC of the European Parliament and of the Council of 17 May 2006 on the statutory audit of annual accounts and consolidated accounts, amending Council Directives 78/660 / EEC and 83/349 / EEC and repealing Council Directive 84/253 / EEC, as subsequently amended and supplemented, and containing clarifications on the application of Regulation (EC) No 537/2014 of The European Parliament And Of The Council of 16 April 2014

Also, in 2019, at the initiative of the Romanian Chamber of Financial Auditors (CAFR), to meet the requirements of the Mandatory Norms issued by Global IIA (IIA) 1 and adopted by CAFR by Council Decision no. 111/2017, as well as to update the initial version of the Guide, issued in 2015 as a result of the collaboration between the Romanian Chamber of Financial Auditors (CAFR) and the Romanian Association of Internal Auditors (AAIR), the Guide on Implementing International Standards was developed of Internal Audit. The purpose of this new edition is to contribute to the maintenance of high quality standards regarding the organization, management and practice of internal audit missions by financial auditors, members of CAFR, who coordinate internal audit

activities, as well as those who are part of the mission teams. This publication does not replace the International Standards on Internal Audit nor the best practices recommended by the Institute of Internal Auditors, being a practical guide, as a reference material for practitioners in the field, the approach being limited to generally applicable aspects, which leaves room for a flexibility of approach, depending on the experience of the professional, the complexity or the specific character of the internal audit mission.

Synthesis of the specialized literature on audit reports

Numerous studies have been conducted over time on the factors that may influence audit reports. As early as the mid-1990s, Wayne Alderman, et al. (1988) examined audit adjustment records for 31 audits of three Big Eight public accounting firms. Financial variables and ratios such as net income, return on assets, return on equity, working capital, current ratio and debt-to-equity ratio were adversely affected to a significant degree by the audit adjustments recorded for the sample company.

Rahnl A. Wood (1996) studied as well the links between cultural, environmental and audit factors while empirically testing these relationships using the canonical correlation. The results suggested that globally, audit characteristics are associated with cultural and environmental factors. Moreover, the country's legal system, literacy level and economic wealth seem to be the most influential determinants of a country's audit environment. This may have implications for global audit harmonization.

At the same time, Nikolaos P. Anastasopoulos, Markos P. Anastasopoulos determined from a study conducted in 2012 that a critical issue in the audit is the reasonable assurance that the financial statements are free from material misstatement. The auditing detection problem can be seen as a two-player game, between the auditor and the auditee, if the auditor aims to eliminate distortions, while reducing his audit efforts, and the auditee seeks financial benefits and fraudulent breakdowns.

David Bryan (2017) also found that the power of trade unions is associated with the quality of audits and internal control, and trade unions have reason to demand high quality audits and strong internal control systems because they are based on financial information in collective negotiations.

Regarding the effects on the price charged by the audit firms in Big 4, Rouven Fleischer, Max Goettsche, Maximilian Schauer (2017), found based on research conducted on a sample of all listed German, Italian, Belgian and Finnish companies from 2007 to 2010, that audit prices differ sharply for existing clients from new Big 4 auditors. The first Big 4 exists only for mandates in which firms do not change their auditor, while when auditors change, Big 4 auditors are willing to give up their first or even accept lower fees than non-Big 4 auditors. This discount prevails in most post-change years. Big 4 applies a foot-in-the-door strategy and requires lower fees to earn new customers. Therefore, the existence of the well-known premium Big 4 is strongly influenced by a company's decision to change its auditor.

Another type of research was done by Habib, et al. (2018), on the relationship between political connections and the quality of financial reporting, audit results and the characteristics of the financial analyst's forecast. They saw the financial reporting system and audit infrastructure as potential missing links between political connections and business performance and, ultimately, economic performance. Thus, the survey revealed inconclusive aspects regarding the decisions of politically connected companies to appoint high quality auditors. However, empirical evidence seems to provide strong evidence for a lower quality of financial reporting of politically connected firms compared to their unconnected counterparts. Although significant progress has been made in understanding the implications of political connections on financial reporting and auditing, major challenges remain in the areas of correct variable measurement, endogenous problem solving and the integration of theories to incorporate policy connections, financial reporting and strong performance.

To test the global public audit policy, Christensen, et al. (2020) conducted a study, the hypotheses being motivated by statements made by regulators, audit standards and theory. On a sample of 246 professional investors in the main experiment and 91 professional investors in two additional experiments, no consistent evidence was identified that investors incorporate material disclosures into their investment decisions. Most importantly, evidence has been found that investors' understanding

of materiality is not in line with regulators' claims. For example, investors fail to make consistent connections between the amount of audit materiality disclosed and the level of the auditor's effort. The results are valid for debt and equity investment settings, for both public and private companies. In conclusion, the findings suggest that disclosures regarding the significance of the audit are not well understood by professional investors and are not considered relevant to the decision. This research informs practitioners, regulators and academics about the effect of disclosure of materiality on investor decision-making, as well as stakeholder views and expectations about overall materiality.

W. Robert Knechel, et al. (2020), concluded that audit research should pay more attention to successful cooperation between the service provider (audit firm) and the client to improve the quality of the audit. Using service network research, they draw attention to a broader perspective than the dyadic relationships of the service provider and the customer to show that the possible frictions between the value of service co-creation and the independence of the service professional are endemic, implying that efforts maximize independence. The central feature of economic services is the participation of the client in the production process. The need for the customer to be a co-producer introduces a greater heterogeneity in the provision of services in relation to the manufacture of goods which, in turn, creates a tension between service quality and service efficiency. One implication of this tension is that standardizing the audit process cannot increase the quality of the audit.

Research methodology

According to the provisions of European and national legislation, the annual financial statements of companies whose securities are admitted to trading on a regulated market are subject to statutory audit. The present study aims to evaluate the audit of the information entered during 2018-2020 in the annual financial statements issued by 30 non-financial entities (Table no.1), listed at Bucharest Stock Exchange (89 annual financial statements in total, one company being delisted in 2019), 12 in Premium Category, 17 in the Standard Category and one in the International Category).

Table no. 1. The composition of the sample grouped by field of activity and stock exchange category

Company Name	Field of activity	Category
Digi Communications NV	Telecommunications	International
Alro SA	Aluminum metallurgy	Premium
Antibiotice SA	Production of drugs	Premium
Biofarm SA	Pharmaceutical manufacturing	Premium
Conpet SA	Oil transport through pipelines	Premium
Electromagnetica SA	Production of electricity metering equipment	Premium
Medlife SA	Specialized healthcare activities	Premium
SN Nuclearelectrica SA	Electricity production	Premium
OMV Petrom SA	Oil and natural gas extraction	Premium
SNGN Romgaz SA	Natural gas extraction	Premium
Sphera Franchise Group	Fast food restaurants and food	Premium
CNTEE Tranelectrica SA	Electricity transport	Premium
SNTGN Transgaz SA	Natural gas transport through pipelines	Premium
Aerostar SA	Production of aeronautical industry components	Standard

Comelf SA	Manufacture of mining and quarrying equipment	Standard
Compa SA	Production of components for the automotive industry	Standard
Electroputere SA	Manufacture of electric motors and generators	Standard
IAR Braşov	Manufacture of aircraft and spacecraft	Standard
Prefab SA	Manufacture of concrete products for construction	Standard
Oil Terminal SA	Standard crude oil loading and unloading	Standard
Oltchim SA Rm. Vilcea	Supply of standard chemicals	Standard
Romcarbon SA	Manufacture of plastic packing goods	Standard
KMG Rompetrol SA	Manufacture of products obtained from crude oil processing	Standard
Ropharma SA	Retail sale of standard pharmaceutical products	Standard
Teraplast SA	Manufacture of plastic plates, sheets, tubes and profiles	Standard
TMK - ARTROM SA	Production of tubes, pipes, tubular profiles	Standard
Turism Felix SA	Hotels and other standard accommodation facilities	Standard
UAMT SA	Manufacture of parts and accessories for standard vehicles	Standard
Vrancart SA	Manufacture of standard corrugated paper and paperboard	Standard
Zentiva SA	Manufacture of standard pharmaceutical products	Standard

Source: data published on the website of the Bucharest Stock Exchange

Results and discussions

The purpose of this study is to find the answers to three questions:

- were the annual financial statements of the listed companies accompanied by audit reports?
- did the audit reports comply with the requirements of international standards and national regulations?
- what are the differences, respectively the similarities between the audit reports?

The method used was quantitative and consisted in analyzing the data entered in the audit reports that accompanied the annual financial statements published on the BSE website. In order to provide the answer to the first question, the situation of the contracts concluded by the audit firms and their periods of validity is presented in Chart no.1 -3, as follows:

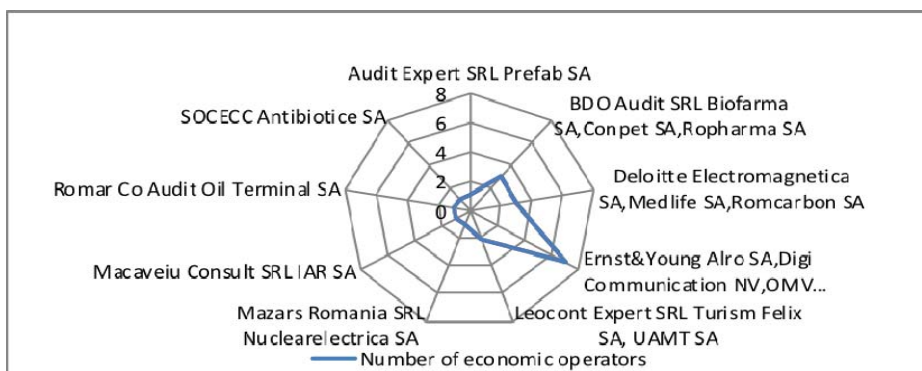


Chart no. 1. Audit firms that have concluded contracts for a period of three years

Source: information resulting from the processing of data published on the website of the BSE

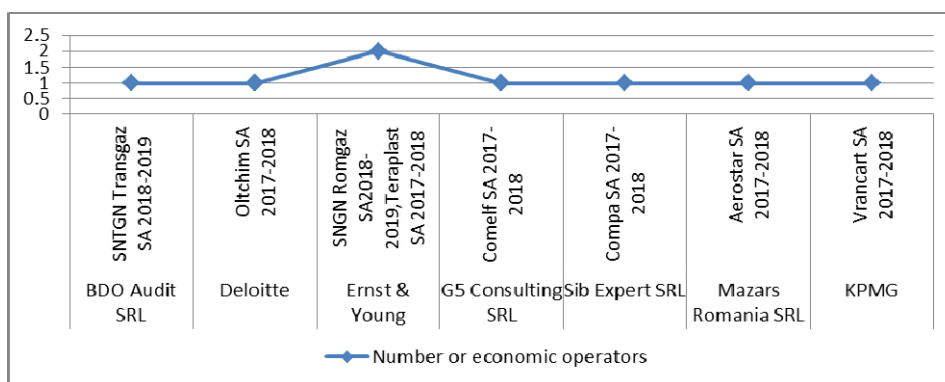


Chart no. 2. Audit firms that have concluded contracts for a period of two years

Source: information resulting from the processing of data published on the website of the BSE

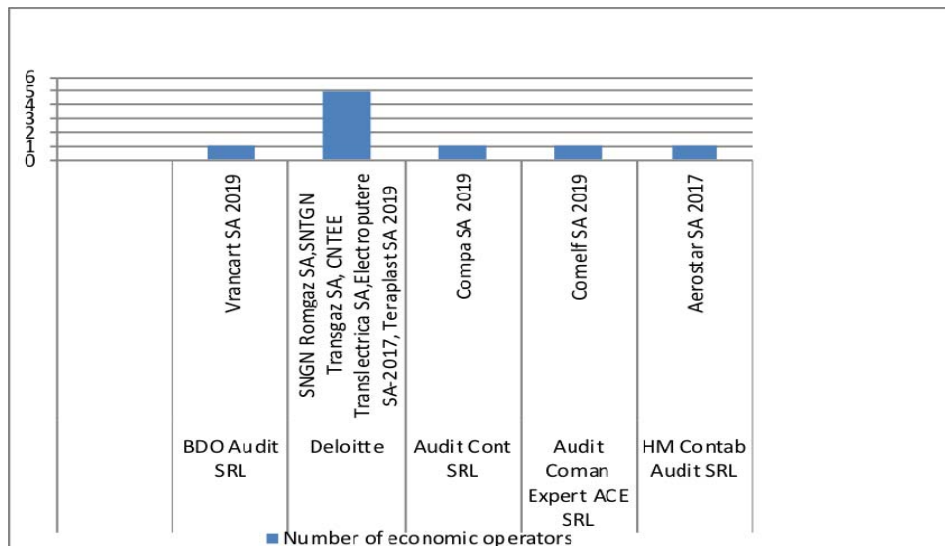


Chart no. 3. Audit firms that have concluded contracts for a period of one year

Source: information resulting from the processing of data published on the website of the BSE

During the period under study, the 89 annual financial statements were audited by 15 audit firms (Figure no.1), five of which with an average turnover in the 2017-2019 reporting period of over 10

million lei and an average number of employees of more than 50 (KPMG, Deloitte, Ernst & Young, Mazars Romania SRL, BDO Audit SRL), and the remaining ten with an average turnover between 120,000 and 800,000 lei and an average of employees between one and three employees (Audit Coman Expert ACE SRL, AuditCont SRL, Audit Expert SRL, G5 Consulting SRL, HM Contab Audit SRL, Leocont Expert SRL, Macaveiu Consult SRL, Romar Co Audit SRL, Sib Expert SRL, SOCECC SRL, Audit & Consulting SRL).

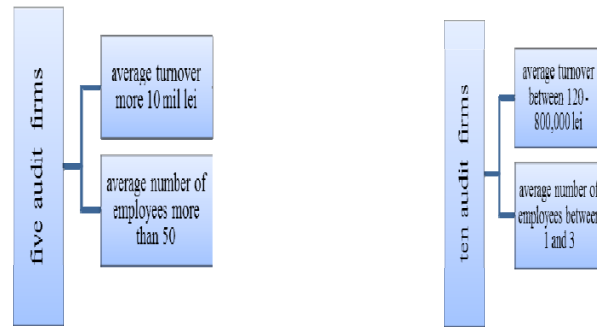


Figure no.1 Audit firms grouped by turnover and number of employees

Source: information resulting from the processing of data published on the website of the BSE

At the same time, it is noted that three companies have prepared the most audit reports, having concluded contracts with the largest economic operators in the sample (Figure no1). Thus, BDO Audit SRL had a contract with seven economic operators (16 audit reports), three in which the majority of shares is owned by the Romanian state (Conpet SA, SNTGN Transgaz SA and CNTEE Transelectrica SA) and four with private capital (Biofarma SA, Electroputere SA, Ropharma SA, Vrancart SA). Deloitte also issued 16 audit reports but for nine economic operators, four with majority state capital (Oltchim SA, SNGN Romgaz SA, SNTGN Transgaz SA and CNTEE Transelectrica SA) and five with private capital (Electromagnetica SA, Electroputere SA, Medlife SA, Romcarbon SA, Teraplast SA), while Ernst & Young prepared 25 reports also for nine economic operators, only one with majority state capital SNGN Romgaz SA, the rest having majority private capital (Alro SA, Digi Telecommunication NV, OMV Petrom SA, KMG Rompetrol SA, Sphera Franchise SA , Teraplast SA TMK Artrom SA, Zentiva SA).

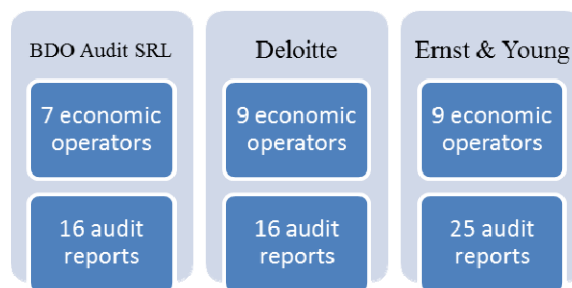


Figure no.2 Audit firms that have prepared the most audit reports

Source: information resulting from the processing of data published on the website of the BSE

Regarding the information about the contract or the additional documents based on which the audit operations are performed, only one company made these clarifications to Leocont Expert SRL, the rest of the companies specifying only the date of appointment of the General Meeting of Shareholders for auditing the financial statements.

Also, in the case of the audit report prepared by Deloitte for the evaluation of the annual financial statement for 2017, issued by SNGN Romgaz SA, the date of General Meeting of Shareholders is not entered, but only the year 2009, and in those prepared by HM Audit SRL- annual financial statement

2017 for Aerostar SA, G5 Consulting SRL- annual financial statement for 2017 and 2018 for SC Comelf SA, Audit Coman Expert SRL - annual financial statement 2019 for SC Comelf SA, Ernst & Young from 2014 - 2017 -2020, they do not contain any information about the contract or about the General Meeting of Shareholders.

Related to the inclusion of audit reports in the annual financial statements (Figure no.3), it was preferred to introduce a copy of the report in 75 cases out of a total of 89, in the remaining 14 cases, the report being presented as a chapter of the financial statement. In the case of introducing copies, they do not always have the auditor's signature, only 37 of 89 (41.6%) being signed. As far as their position in the annual financial statements is concerned, most (48) were presented within, 33 at the end and only eight at the beginning.

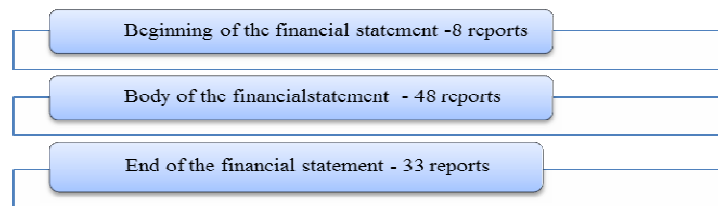


Figure no.3 Inclusion of audit reports in the annual financial statements

Source: information resulting from the processing of data published on the website of the BSE

Regarding the similarities, respectively the differences between the audit reports issued during the audited period, the analysis showed that in general the reports contain the same seven headings (*Opinion, Basis of Opinion, Key Audit Issues, Other information, Management responsibility and those responsible for governance for financial statements, Auditor's responsibilities for auditing financial statements, Report on legal and regulatory requirements*), the only differences being the key audit issues addressed.

These differences present potential risks whose manifestation may jeopardize the good development of the company's activity and which, based on professional reasoning, are of the utmost importance in auditing the financial statements issued over a certain period. As of December 2016 they became mandatory to be published in the case of listed entities, according to the International Standard on Auditing (ISA 701). However, there have been situations when in audit reports prepared by a single audit firm for a company for three consecutive years, all key audit aspects were common, the audit being performed by the same auditor throughout the period (BDO –Biofarma SA, Ropharma SA, Conpet SA, Macaveiu Consult SRL - IAR Braşov SA, E&Y – KMG Rompetrol SA) or even different auditors (Deloitte – Electromagnetica SA, Romcarbon SA). A similar situation is in the case of audit reports prepared for the same company, which changed the audit firm in three consecutive years. This is the case of Compa SA, two different audit firms Sibexpert Expert SRL in 2017 and 2018 and Audit Cont SRL in 2019, highlighted the same key audit aspect.

On the other hand, in the case of audit reports prepared by an audit firm for a commercial company for three consecutive years, it was observed that there were situations when the same auditor of the firm did not notice any common key aspects of audit in any year (Romar Co Audit SRL- Oilterminal SA, Ernst & Young -Zentiva SA) or in the case of audit reports prepared for the same SC, which changed the audit firm during the analysis period, no common key audit aspects were recorded (SNGN Romgaz SA Deloitte 2017, Ernst & Young 2018-2019, SNTGN Transgaz SA – Deloitte 2017,BDO 2018-2019, CNTEE Transelectrica SA – Deloitte 2017, BDO 2018, 2019, Aerostar SA HM Contab Audit 2017, Mazars 2018-2019, Comelf SA – G5 Consulting SRL 2017-2018, Audit Coman Expert ACE SRL – 2019, Terplast SA – Ernst & Young 2017, 2018, Deloitte 2019).

Regarding the audit reports prepared in 2019 by different audit firms for different economic operators, the lack of common key issues for a number of entities was highlighted (Electromagnetica SA, Romcarbon SA, Medlife SA, Terplast SA - the audit firm being Deloitte or Alro SA, SNGN Romgaz SA, KMG Rompetrol SA - the audit being performed by Ernst & Young).

In the case of the reports prepared in 2019 for companies operating in the same field of activity (Figure no.4), it was observed that no common audit aspects were identified both in manufacture of standard pharmaceutical products (BDO – Biofarma SA, E&Y – Zentiva SA, SOCECC-Antibiotice SA) and in the production of automotive components (Audit Cont SRL – Compa SA, Leocont Expert SRL – UAMT SA).

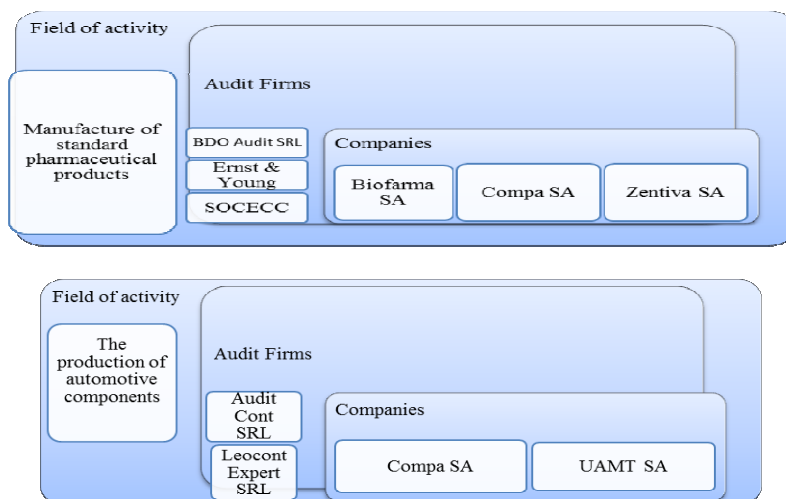


Figure no.4 Companies operating in the same field of activity and for which common key audit aspects were not identified in the audit reports in 2019.

Source: information resulting from the processing of data published on the website of the BSE

At the same time, situations were identified when no key issues were identified in the audit reports, the auditor stating only that he determined that there are no key issues to communicate (Deloitte – SNTGN Transgaz SA - audit report 2017) or that there are no key issues to communicate in addition to the aspects described in the section “Basis for the opinion with reservations” (Deloitte – SNTTE Transselectrica SA- audit report 2017, Audit Expert SRL Prefab SA -audit report -2019).

Conclusions

Following the evaluations, it was observed that all the financial statements were audited, the economic operators preferring that the audit of the financial statements be done by specialized companies that have a large market share and implicit experience in the field. Therefore, three audit companies with an annual turnover of over ten million lei prepared 58 audit reports out of a total of 89. Thus, Ernst & Young prepared 25 audit reports, for nine economic operators, Deloitte, 16 reports also for nine economic operators and BDO SRL 16 reports for seven economic operators.

The audit reports that accompanied the financial statements were introduced as scans of the report in 75 cases out of a total of 89, the positioning being mostly in the financial statements (48), 33 at the end and only eight at the beginning.

With regard to the compliance with the legal requirements, the audit reports have generally complied, with some exceptions. They do not contain information on the legal commitment (contract) under which the audit was conducted, but only the date of approval in the General Meeting of Shareholders, on issuing the opinion with / without reservations or were not signed by the auditor who performed the activity.

In terms of similarities and differences, even though all reports contain in principle the same headings, differentiation was made by key audit issues. Thus, situations were identified when no key audit issues were identified, when for different companies, the same audit firm through the same auditor or different auditors identified the same key issues or no key audit issue was identified, the companies adapted the approach according to the specifics of the activities.

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