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The financial auditor's credibility in postcrisis economic policies

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Abstract. *Given the nowadays economic instability, we might consider that financial auditors could have been one of the important triggers for the economic crisis. Companies that, shortly after undergoing financial audits and publishing their financial statements, seemed to display a viable and true and fair view of their performance in the financial statements – endorsed by financial auditors – faced economic tribulations and needed financial aid to be able to survive on the market, banks' case included. Scholars believe that the banks and investment companies decisively contributed to the unfolding of the financial crisis. This study presents the important role played by the financial auditors in deploying the economic crisis, as well as solutions for re-instating the financial audit activity, as we outline a discrepancy between expectations and results. The role of financial auditors and of corporate governance should shape the economic re-launch by means of differentiated and finely-tuned approaches and be correlated, as well as proportional, with the dimension and characteristics of the audited company.*

Keywords: audit, crisis, credibility, corporate governance, financial institutions.

JEL Codes: M41, M42, H21.
REL Code: 11B, 14J.

Introduction

The existence of economic crisis has generated several problems regarding the banking area and its evolution measured on the national level. As a fact, many financial institutions or investment societies had dealt with huge financial problems or were bought by the government in order to come across their bankruptcy. Not only the ways through which those financial institutions influenced the economy is a general interesting element, but also the fact that these had been audited, and no elements were identified which could suggest the influence of economic crisis upon their evaluation. Establishing high ranking values or subtracting an unfavourable audit opinion upon the financial situation, are facts that ask how reliable this operation had been realized and the way the audited persons' behaviour influence the changes in economic environment. The auditor responsibility and the techniques used by him are also discussed by the Green Paper Document, taking into account that there none signals about the economic crisis appearance had not been identified. Moreover, the auditor responsibility has high magnitude as his opinion should provide reliable information about the financial statements realized by the executive committee.

Even though there are some audit standards that are used in international area, the auditor's opinion shouldn't be questioned. The existence of uncompleted reporting regarding the evaluation process, the connection between the audit staff and the audited society' managers or the pressure upon them for approving and giving a proper and favourable opinion are elements that contribute to the fact that nowadays the auditor opinion has lost a high degree of its credibility.

Literature review

The literature review is revealing the fact that the auditors' behaviour can influence the performance obtained by several entities, either financial institution, either non- financial ones. Sikka (2009) emphasis that the auditors are pointing out that the economic crisis couldn't be predicted, so, as a fact, they were not prepared to evaluate financial problems with such distress. Even considering these, there is a long debate about the bankruptcy of some financial institutions; the bankruptcy that could be justified by the managers' salaries, by the uncompleted reports provided by the audit team or by the unreliable audited techniques that were applied to the audit society.

On the other hand, we can conclude that the managers tend to report unreliable financial information, generally higher results that the results obtained through a financial period, as their remuneration and other financial benefits are high correlated with the performance obtained by the society they managed. Prawitt, Smith and Wood (2009) discovered that there is a strong correlation between the quality of internal audit function and the managers' salaries, formed by abnormal accumulations in their financial statements and also by the propensity to realize the performance established by financial analysts.

The problems that appear are related with the ways that auditors can identify the irrational behaviours, and can use several techniques for mitigating the negative effect that unreliable financial statements can generated.

As a fact, we asked the question who should be or what should be the auditors' activity, taking into consideration the macroeconomic evolution. Bayou et al. (2011) identified that there are still major problems regarding the accuracy of information that the auditors present through their audited reports. The justification can be found in the fact that there are several interest for the stakeholders of the company or of a financial institution through which the financial situation and the auditor report could be manipulated in order to gain those benefits. As a fact, the quality of audit practices is questioned. Humphrey et al. (2007) suggest the fact that when the audit quality is associated with the audit practices, the auditors will react taking into consideration the institutional pressure.

Buchanan and Gibb (2007) consider that the internal audit should emphasis all the information needed that is related with financial indicators in order to identity the proper information taking into account the company's resources. As a fact, the improvement of audited techniques can generate a more reliable and transparent financial reporting and also, can mitigate the activity through which the managers of the company can raise artificially the remuneration related with the performance obtained.

When the correlation between the performance obtained by financial institution and the audit function is analysed, there are some international regulation that are generally applied. In order to assure a minim level of sustainability, the financial institutions are requested to fulfil some economic criteria, criteria which refer to the way of reporting, to the solvability indicators or to other indicators that are requested by the national/internal regulation. As a fact, the supervision institution of the Basel Committee (2002) considers that the existence of an independent auditor is mandatory, and moreover the existence of a strong relationship based on communication between the supervision activity and the activity that the internal and external auditors are pointing out is also compulsory. The explication can be formed in the way that the internal auditors could actually have a supervision function of banking activity, in the way that they can identify the internal risks and can suggest proper measure for vanishing the,. Also, it is mentioned that the manager should be the person who identifies, measures, controls and monitors the risks that can appear beyond the audit activity. As a fact, they should be focused not on reporting a higher performance, the fact that could generate the increase of managers' salaries, but on a correct, proper and reliable reporting technique that can generate the development of financial institution on the long run. Jeong, Jung and Lee (2005) consider that a high degree of audit practices' objectivity could be realized if the auditors would be proposed by a commission, the measure mitigating the connection between the managers that the company has and the persons who give the professional audit opinion. Pierce and Sweeney (2005) reveal that any controls at inferior level haven't been realized, and as a fact, the benefits gained by the audit services are given to partners, fact that is influenced by the opinion that they provide.

Pollitt et al. (1999) identify the fact that the audit and the performance of audit practices is essential in order to establish the credibility of audit used techniques. On the other hand, he points out that depending on the place where these policies are applied, the accounting and audit practices are different. As a fact, the managerial principles are different, and the influence of governmental programs upon the performance obtained is high correlated with them.

Regarding the connection between the financial institutions' performance and the audited techniques, it is considered that the audit should provide a minimum level of assurance when the financial statements are discussed, as Arens, Elder and Beasley (2012) suggested. On the other side, Otusanya and Lauwo (2010) point out that the auditors and the auditing practices had an crucial function in Nigeria by approving low financial performance and influencing in this way the bankruptcy of many financial and non-financial companies.

Li (2010) established an idea through which the audited practices could be improved by using the linear programming techniques, but he also reveals the fact that there is not an exhaustive application of these techniques when the financial institutions have different ways of reporting their indicators, while other specialists suggest that the improvement is obtained firstly by the internal audit which has to monitories the operational risk practices.

Nonetheless, we have to evaluate the meaning of word "performance", and moreover the meaning of" bank performance". This has an ambiguous meaning as there is not a general concept accepted through the financial literature. Bergendhal (1998) considers that among the profit maximization, the risks implied by the banking activity, the intermediation function, the provision and the way they are used are elements that define the performance in a general way. Kosmidou and Zopounidis, D (2008) point out that the bank performance can be expressed in multiple ways, from banks that report the increasing of the net profit, to banks that use several techniques in order to attract more clients and to become more competitive on the market, to banks that obtained high financial loses and are characterised by economic decline. Hays, De Lurgio, and Gilbert (2008) emphasise the importance of discriminant analysis in evaluating the performance of financial institutions by revealing the factors that can determine is a bank is in bankruptcy or not.

Taking the Romanian national level, a recent study about the bank performance was realized by Munteanu and Brezeanu (2012), by comparing the classical ways of measuring performance with the modern ones like EVA, MVA. They concluded that some Romanian banks are value creators, while others do not add value to the Romanian economic environment.

Taking this into consideration, the question about the reliable and proper are the financial situations and if the performance obtained by the financial institutions has or not a high degree of credibility.

The research methodology

In order to identify the function of financial audit upon the performance obtained by the financial institutions from Romania, we considered that pointing out some performance indicators is important and also the ratings given by a rating company. The data for establishing the rating was offered by Flich Company, as it is one with a high degree of credibility among users.

The idea of research was based on the fact that for observing the evolution of financial institution for a long period of time, the companies that act in the Romanian market for at less 3 year period were analysed. The idea was to realize a comparison between the profitability indicators chosen before and after the economic crisis came into discussion. As a fact, the data were analysed for a 5 year period. The data have been taken form financial statements of the companies analysed.

Not only the financial situation on the long run was analysed, but also the way that auditors provide favourable opinions to financial institutions. We can observe that, even though in some financial audit reports modification about elements from financial statements are stipulated, like Transilvania Bank case, no changes in the auditor opinion could been identified.

The analysed was realized using 10 banks from Romania, chosen by the amount of credits offered to the public and also by realising their activity from a long period of time.

In order to quantify the performance obtained, the following indicators of financial performance were analysed:

- Net profit- it is considered to be a performance measurement as it points out the financial result obtained through the analysed period.

- The general liquidity ratio – calculated as ratio between liquidity assets that the bank has and the current liabilities of the institution.
- The ratio calculated by dividing the amounts of credits given to the public to total assets, the ratio determine in order to reveal have the company is going to act in the long run.
- The solvability indices which has to take into account the regulation imposed by the National Bank of Romania, by considering the restriction imposed to own funds.
- The general risk ratio – established as the ratio between the value of balance sheet and outside the balance sheet assets multiply with their risk coefficient and the amount of own funds.

The period through which the elements form the financial statements were analysed was between 2005 and 2009. This period was chosen in order to reveal the period before the Romania has entered the European Union, the moment of entrance (2007), and also the period when the financial crisis started, this being considered by some specialist in 2008, while others refer to it as the beginning of 2009. What we wanted to focus was firstly the evolution of the indicators analysed. After that, we try to establish a correlation on one side with the audit standards and the international one, and on the other side a correlation with the rating offered to them, and the way the market risk raised on the Romanian market. After that, we put into discussion elements that can improve the audit techniques, that can generate a higher credibility of them and that can integrate in more detail the financial audited statements among them.

Findings and discussion

The first element that was analysed was the net profit that the company obtained through the period analysed. This is presented in the next table

Table 1. *Diferences between net profit calculated by using a ratio*

Institution	2006/2005	2007/2006	2008/2007	2009/2008
Banca Carpatica	1,08	1,90	0,02	-46,26
Banca Romaneasca	3,72	1,04	1,51	0,12
BT	1,21	2,83	1,17	0,16
BCR	1,10	1,33	2,20	0,57
BRD	1,43	1,45	1,54	0,73
Credit Europe	1,02	0,15	5,53	-1,11
OTP	1,21	0,81	-0,33	-1,05
Piraeus	0,47	24,12	1,39	2,11
Procredit	1,77	0,63	-2,07	-2,65
Raiffeisen	0,76	1,98	3,01	0,40

Source: own calculation.

As it can be seen in Table 1, some financial institutions started to obtain financial loses at the end of 2008, while others, the effects of the international economic crisis began in 2009. Even though the majority of financial institution reported important loses, the auditors haven't identify any problems regarding the financial statements of them. What it should be improved is the way that analytical procedures are applied through a long period of time in order to point out that the results are based on reliable information. As a fact, the auditors should confirm the accuracy of financial information presented in the financial statements, by comparing the net profit obtained and the gross margin of profit. Also, when the evaluation of net result is realised, they have to take into account not only the financial information, but also the information that has a non-financial character.

Regarding the solvability of the banks, we can admit that there is not any rule established by the National Bank of Romania unapplied. As a fact, even though the companies analysed seemed to have a strong sustainability on the long run, one essential element is realising the correlation of calculated indicator with the rating offered by the Fitch company, facts that are presented in Table 2.

Table 2. *The rating offered by Fitch Company to the financial institution analysed*

Institution	Banca Carpatica	Banca Romaneasca	BT	BCR	BRD	Credit Europe	OTP	Piraeus	Procredit	Raiffeisen
Rating	B	B-	BB-	BBB+	BBB+	B+	BBB+	CCC	BBB-	BBB-

Source: own calculation.

At a deep analysis, we observe that many financial institutions suffered a decrease in their rating offered by Flich Company among the period analysed. This aspect deals with the fact that the total confidence in the degree of performance obtained by companies has decrease sharply, element that point out an unfavourable effect among different stakeholders. From this point of view, the auditors have to pay more attention to the financial situations, pointing out, as often as is necessary, detailed reports about some elements from financial situations that can raise important problems regarding the credibility and reality of them. Moreover, the auditors should analyse the results obtained by the company by comparing them with the companies expectations and by revealing if the differences obtained are justified or not, taking into consideration that they have to provide a minimum level of assurance.

Another indicator that was analysed was the general liquidity rate of the company. From the financial institution analysed, 40% had values under the 100% threshold. These banks are presented in the next table:

Table 3. *The general liquidity ratio*

Institution	2005	2006	2007	2008	2009
Banca Romaneasca	106,85%	70,37%	34,07%	37,93%	32,15%
BRD	157,69%	107,43%	81,83%	86,03%	71,86%
Piraeus	112,14%	67,87%	75,78%	74,53%	83,08%
Raiffeisen	146,57%	93,08%	79,65%	100,52%	107,66%

Source: own calculation.

As it can be seen from the previous table, the banks that have important problems when the general liquidity rate is analysed are BRD, Banca Românească and Piraeus Bank. As a fact, the auditors have to establish a proper amount of objectivity and to practice a professional behaviour when interpretation to the indicator is conferred. As a fact, the auditors should write a distinctive paragraph in their audit report, where they must present their own opinion regarding the way the indicator would influence the companies' profitability. In the case that the payment of current liabilities is necessary to be made, the financial institutions could have problems when the liability issue is discussed. Moreover, an efficient communication between auditors and shareholder deals with creating or suggesting some ways of cutting off the financial distress. Nonetheless, there has to be an efficient communication between the internal and external auditors and the shareholders in order to provide that there are not gaps regarding the monitoring and detailed checking of the elements from financial statements.

Another indicator analysed is the percentage of credits given to the public divided to total assets. A summary statistics of the variable analysed is presented in Table 4.

Table 4. *Summary statystics of credit to assets ratio*

Institutuin	Minim	Year	Average	Maxim	Year
Banca Carpatica	34,73%	2009	52,27%	60,03%	2005
Banca Romaneasca	61,20%	2009	63,77%	67,55%	2007
BT	59,10%	2009	61,22%	64,70%	2008
BCR	47,25%	2005	58,66%	67,62%	2009
BRD	51,38%	2005	63,24%	69,92%	2009
Credit Europe	64,70%	2006	68,66%	74,22%	2007
OTP	43,73%	2005	58,94%	71,94%	2008
Piraeus	52,91%	2006	61,90%	68,18%	2008
Procredit	67,18%	2005	70,14%	74,09%	2007
Raiffeisen	46,46%	2005	50,54%	55,31%	2008

Source: own calculation.

From Table 4 it can be seen an important increase of the crediting operation as the Romania became a member of European Union. The explication can be found it that period, the level of interests was relative low, in order to facilitate the credit operation as new investment could have been realised with an important impact upon the economic growth. As a fact, we consider that auditors should pay plenty of attention to the way the financial institution offers funds to the Romanian population and to Romanian companies, if it offers some benefits to the customers and if the risk that it assumes is not to high.

The last indicator analysed is the general rate of risk. This indicator is pointing out which is the risk that the company assumes. As a fact, it takes into consideration not only the elements form the balance sheet, but also the elements which are presented outside the balance sheet.

Table 5. *The evolution of general rate of risk*

Institution	Minim	Maxim	Trend
Banca Carpatica	60,65%	76,46%	Fluctuating increase
Banca Romaneasca	66,49%	71,44%	Constant between the average
BT	69,64%	73,03%	Constant between the average
BCR	58,35%	75,19%	Increasing shaply
BRD	63,12%	78,64%	Increasing shaply
Credit Europe	69,04%	78,64%	Increasing shaply
OTP	51,24%	73,02%	Increasing shaply
Piraeus	67,87%	112,14%	Decrease
Procredit	70,24%	77,00%	Fluctuating increase
Raiffeisen	40,56%	100,95%	Decrease

Source: own calculation.

From the previous table, it can be identified the fact that in general Romanian banks continue to increase their general risk, as the percentage of toxic assets has increased, elements that can influence the performance obtained through a fiscal period of time. As a fact, we consider that the auditor role is crucial, as they have to reveal a proper opinion regarding the results obtained. Also, they should realize a more detailed analysed by comparing the results with those that characterize the average of the area where the company acts and moreover, by comparing the results with the results obtained in previous financial years.

In the situation where the risks that the bank is supporting is not identified, the auditor should be the person who try to signals some toxics behaviours, by pointing out the elements that can affect the performance not only at the bank level, but also at national one.

Other aspects regarding the audit during crisis periods of time

Taking into account the importance of audit practices, it is mandatory for the audit to respect the behaviour principles and to keep a degree of objectivity when he evaluates the financial statements. Moreover, the auditor has;

- To be independent by the shareholder distribution is analysed;
- His remuneration should not be correlated with the benefits gained by the managers or by the performance obtained by society by presenting unreliable information;
- To respect the deontological and professional principles of audit profession;
- To present detailed reports regarding the financial situation of the company taking into account that these kind of information are essential for stakeholders;
- He has to analyse the activity of the bank not only by comparing it with the results from the previous period, but also by comparing the performance with the performance obtained at sectorial or national level, and also by comparing with the companies' expectations.

Conclusions

The audit role is to assure the financial statements of the institution audited are credible, taking into account the deontological and professional principles. The problems that appear are connected with the fact, in the actual economy, the credibility of auditors is questioned as it is viewed taking into account recent financial distresses happened through financial institutions.

As a fact, we considered that a special attention should be paid to financial sector, not by considering the bankruptcy for important banks on the international level, even though the audit haven't observed any financial problems, but also from the point of view when the banking sector is the area that influence the whole economy. Due to this aspect, an inadequate evaluation of this system can generate important problems not only on the national level, but also on the international one.

As a fact, the performance or the indicators that are measured at banking level are definitely important for the repercussions that they could have. This article followed the evolution of 5 financial indicators that can affect the profitability and the performance of financial institution on the Romanian market.

Regarding the research, lags of it are due to the lack of transparency of Romanian banks and also are due to the fact that few banks are listed on the Bucharest Stock of Exchange. Further research could be realised by evaluating the performance measured by financial indicators of the entire Romanian Banking Market and by realising a econometric model in which a connection between performance, audit indicators and managers' salary could be found.

The conclusion of the study is that the Romanian market has not a high degree of risk when the financial sector is analysed, and that the banks are not going to come immediately to a bankruptcy. The auditor opinion should be more prudential, he should present a detailed report about each element that could generate futures problems and moreover he should provide information about indicators or fact that can generate the modification of financial problems. This fact has to be discussed with the directors of the financial companies, in order to adopt a proper decision that would not affect the future performance.

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