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COMMENTS ON "EMPIRICAL EVIDENCES OF ROMANIAN AUDITORS' BEHAVIOR REGARDING CREATIVE ACCOUNTING PRACTICES"

Tal LAHAV[1]
KPMG in Romania

The research paper tries to find a conclusive answer as to whether the number of years of professional experience of the auditors influences their perception regarding the quality of financial statements, whether there is a correlation between the professional experience of the auditors and the incidence of creative accounting practices encountered in their auditing missions, whether the existence of an efficient internal control system determines the auditors' perception regarding the tendency to use creative accounting practices, and whether the possibility to identify the creative accounting tendencies is strongly correlated to the frequency of creative accounting practices encountered in auditing financial statements of Romanian companies. The authors validate the first two research propositions, and do not validate the last two of them.

In trying to address this topic, one should first understand a few important concepts related to an audit of Companies' financial statements:

In conducting an audit of financial statements, an auditor's overall objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework, and to report on the financial statements, and communicate as required, in accordance with the findings.

An auditor's opinion on the financial statements deals with whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework. Such an opinion is common to all audits of financial statements. An auditor's opinion, therefore, does not assure, for example, the future

[1] *Correspondence address*: Tal Lahav, Senior Manager, Audit, KPMG in Romania,
Victoria Business Park, DN1, 69-71 Bucureşti-Ploieşti Road, Sector 1, 013685, Tel. +40741 800 800,
email: tallahav@kpmg.com

viability of the entity nor the efficiency or effectiveness with which management has conducted the affairs of the entity.

The financial statements subject to audit are those of the entity, prepared by management of the entity with oversight from those charged with governance. Therefore, audits are conducted on the premise that management, and where appropriate, those charged with governance, have acknowledged and understand that they have responsibility: a) for the preparation of the financial statements in accordance with the applicable financial reporting framework, including where relevant their fair presentation; b) for such internal control as management and, where appropriate, those charged with governance determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; and; c) to provide the auditors with access to all information and persons within the entity.

The preparation of financial statements involves judgment by management in applying the requirements of the entity's applicable financial reporting framework to the facts and circumstances of the entity. In addition, many financial statement items involve subjective decisions or assessments or a degree of uncertainty, and there may be a range of acceptable interpretations or judgments that may be made.

There are inherent limitations in an audit which arise from the nature of financial reporting, the nature of audit procedures, and the need for the audit to be conducted within a reasonable period of time and at a reasonable cost.

Consequently, some financial statement items are subject to an inherent level of variability which cannot be eliminated by the application of additional auditing procedures. For example, this is often the case with respect to certain accounting estimates.

Further, fraudulent financial reporting involves intentional misstatements including omissions of amounts or disclosures in financial statements to deceive financial statement users. It can be caused by the efforts of management to manage earnings in order to deceive financial statement users by influencing their perceptions as to the entity's performance and profitability.

In addition, fraud may involve sophisticated and carefully organized schemes designed to conceal it. Therefore, audit procedures used to gather audit evidence may be ineffective for detecting an intentional misstatement that involves, for example, collusion to falsify documentation which may cause the auditor to believe that audit evidence is valid when it is not. Auditors are neither trained as nor expected to be an expert in the authentication of documents.

Such a situation could occur when, due to pressures to meet market expectations or a desire to maximize compensation based on performance, management intentionally takes positions that lead to fraudulent financial reporting by materially misstating the financial statements. In some entities, management may be motivated to reduce earnings by a material amount to minimize tax or to inflate earnings to secure bank financing.

Therefore, one should first understand whether the research paper when referring to “creative accounting practices” is implying to fraud related “creative accounting practices” or implying to accounting treatment, mainly related to financial statement caption susceptible to significant estimation uncertainty “creative accounting practices”. The main difference between the two is the intentions.

As a matter of practical experience, in high terms I tend to agree with the results of the research paper with respect to the propositions made with a reservation that such propositions are not matters of conclusive evidence as auditors are operating based set of guidance that embed in it a set of professional scepticism and other frameworks that help prevent an auditor from making assumption and operate based on perceptions.

As to the propositions themselves, indeed the proposition that the number of years of professional experience of the auditors influences their perception regarding the quality of financial statements is difficult to validate. Moreover, there appears to even be an inverse relation between the level of experience of an auditor to his perception of the quality of financial statements which arise from gaining more knowledge and experience over time to better understand financial statements users’ needs and the ability of the financial statements to address those needs.

As to the proposition that there is a correlation between the professional experience of the auditors and the incidence of creative accounting practices encountered in their audit missions, again, our practical experience will usually show that this is difficult to validate. This will be applicable both for fraud related “creative accounting practices” and accounting treatment, mainly related to financial statement caption susceptible to significant estimation uncertainty “creative accounting practices”.

As to the proposition that the existence of an efficient internal control system determines the auditors’ perception regarding the tendency to use creative accounting practices, one would assume that the perception of the auditors would be that there would be less tendency for “creative accounting practices” but in practical terms the existence of internal control will not automatically result in changing on any audit procedure that would have been performed should such internal control department would not exist – rather existence of internal control department may allow the

auditors to perform additional audit procedures to be able to rely on the internal audit department to change the nature, extent, and timing of further audit procedures.
Finally, with respect to the proposition that the possibility to identify the creative accounting tendencies is strongly correlated to the frequency of creative accounting practices encountered in auditing financial statements of Romanian companies, to an extent this is a reasonable assumption. Knowledge and experience is gained to be able to identify "creative accounting practices", both due to fraud and to accounting treatment, mainly related to financial statement caption susceptible to significant estimation uncertainty but in practical terms auditors obtain relevant training to be able to identify such "creative accounting practices" which may compensate for lack of such prior experience.

From our experience, one must distinguish between fraud related "creative accounting practices" and accounting treatment, mainly related to financial statement caption susceptible to significant estimation uncertainty "creative accounting practices".

One must remember that accounting treatment, mainly related to financial statement caption susceptible to significant estimation uncertainty "creative accounting practices", even though sometimes may appear aggressive, is not a wrongdoing by management as long as those comply with accounting framework.