

## **The “Big Four” and “Sai”– A Case Study on the Management of Financial Audit Independence**

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### **Abstract**

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The process of financial auditing and the auditors themselves must be independent and perceived as such. We analysed a sample of the companies that received financial auditing by the Big Four auditing firms in Romania and that parallel a sample of Romanian Court of Accounts audited companies. The conclusion suggests a difference in the audit opinion of these two groups, which might be the result of direct payment for contracted services or of the lack of such a connection. The lack of any moneyed connection between the auditor and the audited would improve financial audit independence.

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### **Introduction**

As Stanford University economist Paul Romer has perceptively warned, “A crisis is a terrible thing to waste”. Fortunately, Romer’s observation produced some effects, particularly in regard to debates concerning the causes of the global financial crisis, either in the field of research or in financial and economic practices. Financial auditing has benefited from that challenge.

The actual economic and financial crisis undoubtedly had numerous causes. The crisis began in the banking and insurance system and spread to companies in different fields. Questions remain regarding how the crisis was possible, whether anyone is guilty, what the causes were and what is to be done so that the effects of the crisis will not be extensive and damaging.

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Political leaders and representatives from economic and financial organisations have widely discussed possible options for stopping the course of the crisis. Among these considerations, the officials suggested that money from the state might be a good option, but they did not take in account that this solution would affect people's financial comfort. As a result of such a measure, changes in the ideological beliefs of some public opinion-makers could even be noticed, and worse, people's confidence in the financial system has been dramatically affected. Concerning the bankruptcy of certain banks and large private companies, there have been fewer debates and correspondingly insufficient ideas about the causes. Therefore, we suggest that honest debates on the crisis' actual causes and contributions should come from professional organisations rather than from the political world. In this manner, confidence in the financial world would be restored.

Could financial audit, in its organisation and exercising, be one of the causes of the crisis? Audit has been viewed as a lever to increase the credibility of financial information, and its independence both in reality and in perception appears to be critical.

In our opinion, weaknesses in financial audit independence did not determine or at least were not the primary cause of bankruptcy in certain companies and banks. However, financial auditing might have better prevented the negative course of some companies' financial situations if professional audit standards were more effectively applied. In some respects, the economic and financial world required additional transparency in revealing basic financial information and needed more efficient organisation of the systems known as the "internal control system" and the "risk management system". Proposals have been made to improve the methods of enforcing the standards of financial auditing.

The International Federation of Accountants (IFAC) issued the International Standards of Audit (ISA) that financial auditors refer to in their activity. Other rules and standards<sup>2</sup> also have been issued regarding accounting activity and reporting systems. In addition, recommendations have been issued to all economic and financial organisations, including the majority of countries, regarding how to improve their accounting activity and what to do to enhance transparency.

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<sup>2</sup> <http://www.ifac.org/About/Publications.php>

To assist professional accountants in addressing the issues related to the global financial crisis, IFAC and the International Auditing and Assurance Standards Board (IAASB) have focused on the following three activities:

- To increase awareness among the preparers and auditors of existing and newly developed guidance that can assist these officials in reporting on financial instruments;
- To encourage further convergence in reporting standards on financial instruments while at the same time strongly supporting (the continuation of) fair value accounting because reducing transparency is not in the interests of investors; and
- To participate in and promote discussions regarding best practices with respect to the audits of financial institutions and other organisations that are affected by the current crisis<sup>3</sup>.

As a professional organisation, IFAC recently submitted recommendations regarding the reform of the global financial system to the G20 working groups that met during the 2009 London Summit, a subject that we will cover in another paper.

After the crisis began in 2010, the European Commission, one of the main regulators, issued a so-called green paper<sup>4</sup> that aimed to strengthen the rules of accounting and specifically to improve the independence of financial auditing. Included in the green paper were provisions that referred to eliminating the money between the auditors and the audited by creating a special regulator to independently nominate the auditor and to introduce the principle of rotation in assigning the auditors. The IFAC did not fully agree with these proposals.<sup>5</sup>

Researchers demonstrated that there are connections between the type of audit report and the auditors' awareness or even unconscious interests or factors (Chan & Kogan, 2012; Constantinides, 2002; Geiger & Raghunandan, 2002; Moore et al., 2003; Rosman, 2011; Tara, 2011).

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<sup>3</sup> <http://www.ifac.org/financial-crisis/>

<sup>4</sup> Green paper audit policy: lessons from the crisis. <http://eur-lex.europa.eu/lexuriserv/lexuriserv.do?uri=com:2010:0561:fin:en:pdf>

<sup>5</sup> European Commission's green paper, *audit policy: lessons from the crisis* ifac response <http://www.ifac.org/sites/default/files/publications/files/european-commission-s-gre.pdf>

Based on these researchers' findings and on our analysed case results, we suggest that the independence of financial auditing could be improved by finding solutions that eliminate, as much as possible, the material connections between the auditors and those being audited.

To accomplish their mission, financial audit officials and auditors must comply with several basic principles of ethics that are required by The Code of Ethics for Professional Accountants. Both the activity and auditors themselves must be **independent**. The fundamental principles stated by the ethics code include the following: integrity, objectivity, professional competence and due care, confidentiality, and professional behaviour.<sup>6</sup>

Although it is not our intent to detail the principals here, we underscore the importance of independent financial audit activity to ensure that the opinion of the auditors will be credible and consequently useful.

Using different criteria one can identify several types of financial audit activity. In our opinion, two types are particularly important to ensure independence. Thus, taking in account the organisational position of the activity, one can examine internal audit and external audit. Internal audit is organised inside of any entity required to respond to the interests of that entity management. As "an employee", an internal auditor is materially connected to the management interest and therefore not always objective; the auditor might be considered relatively independent. External financial audit is an activity that comes from outside an entity. The auditors are not employees; consequently, the auditors are viewed as more objective and their independence appears to be more real.

Another criterion for classifying the forms of financial audit is the organisations to which the auditors belong. From this point of view, financial audits are exercised by auditors belonging to the following: entities (internal auditors), professional organisations and supreme audit institutions. The last two forms appear as an external audit because these forms come from outside an entity. The difference is related to the fact that the supreme audit institution (SAI) usually belongs to the Parliament and exercises financial audit on the public funds.

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<sup>6</sup> The Code of Ethics for Professional Accountants (revised 2006), International Ethics Standards Board for Accountants, 2008, <http://web.ifac.org/publications/international-ethics-standards-board-for-accountants/code-of-ethics#2010-handbook-of-the-code-o>

There is also a very useful difference between the professional organisation's audit and the audit of the SAI. Namely, there is no material connection between those two audits as long as the financial audit activity is compulsory for public agencies and without any direct payment. That procedure ensures stronger objectivity and actual independence.

This paper is structured in the following manner. First, we provide an overview of the primary approaches regarding financial audit independence in both scientific literature and in the regulators' work. We then provide an analysis of data published by the Big Four auditing firms and their audited companies and the Romania Court of Accounts, along with the results and proposals of other authors in the field. The final portion draws conclusions and explains further proposals.

### **The Main Scientific Background and Regular Framework**

The independence of financial auditing is an important requirement for financial information credibility. To increase confidence in the reality of financial information, there is a need for an independent opinion. Therefore, regulators examined the independence of financial audit when issuing the international standards as examples of good practices in the field.

According to the International Standards of Audit (ISA 200)<sup>7</sup>, financial audit consists of the verification and certification that is independently conducted by a responsible professional regarding the annual accounts and financial statements of any company and is aimed at expressing an opinion connected to the reality of information issued by these companies' synthetic documents.

In an independent examination and expression of opinion on the financial statements of an entity, the financial audit role is to report on the truth and fairness of the financial statements on behalf of their users. Auditors provide an opinion on whether the financial statements are prepared in accordance with an acceptable financial reporting framework (e.g., the international standards of financial reporting) and with any specific statutory requirements (e.g., rules and laws).

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<sup>7</sup> <http://www.ifac.org/sites/default/files/downloads/a008-2010-iaasb-handbook-isa-200.pdf>

The INTOSAI's Code of Ethics<sup>8</sup> issued by the Auditing Standards Committee at the XVI Congress in 1998 states that "the auditor should behave in a way that increases, or in no way diminishes their independence," and "in all matters relating to the audit work, the independence of auditors should not be impaired by personal or external interests." The auditors must be independent not only in fact but also in appearance.

As the national professional organisation of certified public accountants (CPAs) in the United States, the American Institute of Certified Public Accountants (AICPA) defines the independence of audit as an absence of interests that create an unacceptable risk of material bias with respect to the reliability of financial statements (Elliott & Jacobson, 2002).

Regulators' emphasis on enhancing the real independence of financial auditing is exemplified by the Sarbanes-Oxley Act ("The Act"), which after 2001 placed the audit committee - rather than management - in charge of hiring auditors and overseeing engagement. The act also prohibits auditors from providing certain non-audit services to clients and imposes mandatory audit partner rotation. These measures were a part of Congress's response to financial scandals at Enron, WorldCom, and elsewhere. Congress also established independent oversight of the auditing profession through the Public Company Accounting Oversight Board (PCAOB) for the audits of issuers.<sup>9</sup>

Another important regulator is IFAC, which provided an answer to the proposals coming from the European Commission with the document "Green Paper Audit Policy: Lessons from the Crisis".<sup>10</sup> The main provisions of the EU document referred to the following issues: a possible conflict in the auditor being appointed and remunerated by the audited entity; whether the appointment by a third party was justified in certain cases; and whether the continuous engagement of audit firms should be limited in time. The EU Commission proposals referred to the improvement of the independence of financial audit. The answer<sup>11</sup> from the IFAC was essentially "not" being justified that there are enough provisions of the actual audit standards to properly cover all the issues.

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<sup>8</sup> [http://www.tide.org.tr/uploads/INTOSAI\\_COE\\_and\\_Standards\\_01-05.pdf](http://www.tide.org.tr/uploads/INTOSAI_COE_and_Standards_01-05.pdf)

<sup>9</sup> [http://pcaobus.org/rules/rulemaking/docket037/release\\_2011-006.pdf](http://pcaobus.org/rules/rulemaking/docket037/release_2011-006.pdf)

<sup>10</sup> <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2010:0561:FIN:EN:PDF>

<sup>11</sup> <http://www.ifac.org/sites/default/files/publications/files/european-commission-s-gre.pdf>

The Institute of Internal Audit Standards defines the concept of the independence of financial audit in the following way: "The independence is the freedom from conditions that threaten objectivity or the appearance of objectivity. Such threats to objectivity must be managed at the individual auditor, engagement, functional and organisational levels."<sup>12</sup>

The Independence Standards Board (ISB) came into existence in May 1997 with a mission to set up independence-related standards that can be applied to the audits of public companies for serving the public interest and for protecting and promoting the confidence of investors in the securities market.<sup>13</sup> In 2001, however, the organisation closed its doors without accomplishing the mission of setting up an independence framework. Discussing the shutdown, Professors Alan S. Glazer from Franklin & Marshall College and Henry R. Jaenicke from Drexel University (Glazer & Jaenicke, 2002) noted the "pathology of the ISB's conceptual framework project, which ultimately affected the board's ability to survive".

Despite the fact that the real independence framework is not about "threats and safeguards" and "independence in appearance," Elliot and Jacobson (1998), in their paper "Audit independence: concepts and application", designed a set of eight principles for regulating independence. The principles are consistent with the researchers' approach toward the independence of financial audit as being what AICPA accepted as "an absence of interests that create an unacceptable risk of material bias with respect to the reliability of financial statements."

Other researchers consider both the independence of financial audit and the different ways in which financial auditors behave in certain circumstances, noting a connection between the conditions in which auditors perform their mission and the type of audit opinion. As human beings, auditors could be biased and react differently in different conditions. In this respect Kunda (1990), Thompson and Loewenstein (1992) and Babcock and Loewenstein (1997) demonstrated that people process information in a biased, self-interested fashion and that this behaviour is "strong, automatic and unconscious".

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<sup>12</sup>[http://www98.griffith.edu.au/dspace/bitstream/handle/10072/34073/64443\\_1.pdf?sequence=1](http://www98.griffith.edu.au/dspace/bitstream/handle/10072/34073/64443_1.pdf?sequence=1)

<sup>13</sup> [http://www.readyratios.com/reference/accounting/independence\\_standards\\_board\\_isb.html](http://www.readyratios.com/reference/accounting/independence_standards_board_isb.html)

The auditor's independence can be influenced by the connection with the amount and the fee of the non-audit services, Steven Cahan & Co demonstrated in 2008.

In a paper, published in 2008 in "The Journal of International Financial Management & Accounting", Z Jun Li & Co showed that the independence of the auditors determines not only the quality of the audit but will also influence the decisions of the investors.

Auditors generally want to be rehired by their client, which is why unfavourable audit opinions are likely to be issued only in the case when such an interest does not exist (Levinthal et al., 1992). Rosman (2011) showed that financial auditors are adaptive in ill-structured tasks and Geiger and Raghunandan (2002) confirm the SEC opinion that auditors are influenced by litigation pressure. Geiger et al. (2005), in their paper titled "Recent Changes in the Association between Bankruptcies and Prior Audit Opinions", documented a connection between financial auditors' decisions and the degree of the regulation of the audit activity and the audited companies.

Deborah L. Lindberg and Frank D. Beck<sup>14</sup>, in their scientific paper "CPAs' perceptions of auditor independence: an analysis of views before and after the collapse of Enron", found that CPAs' perceptions of the effects of non-audit services on auditor independence are more negative *after* the bankruptcy of Enron, compared to CPAs' perceptions of such services on auditor independence *before* the bankruptcy of Enron" and that "auditors believe non-audit services and other issues that threaten auditor independence detrimentally affect the public's *perception* of independence to a greater extent than they adversely influence *actual* independence."

The most eloquent study on which we primarily base our conclusions is "Auditor Independence, Conflict of Interest, and the Unconscious Intrusion of Bias", a scientific paper published by Moore et al. (2003) from Harvard Business School. The authors conducted a laboratory study on the behaviour of financial auditors in different circumstances, suggesting that modifications occur in auditor decisions under certain circumstances. The conclusions from their experiments include the following:

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<sup>14</sup> <http://aaahq.org/audit/midyear/03midyear/papers/AuditorIndep-paper1-AuditingSection.isu.pdf>



People tend to be proactively responsive to those to whom they expect to be accountable. An auditor who feels accountable to his client is more likely to issue a clean, unqualified audit report than one who feels accountable to an audit partner in his firm. The conclusion is also supported by others (Buchman et al., 1996; Tetlock, 1983) and primarily reflects the weaknesses of the independence as a principle when an auditor knows he is accountable to someone. The conclusion supports the idea of rotation and of a third part in the process of assigning the auditors.

The second conclusion is that financial incentives have a stronger influence on public reports than on private beliefs. It takes very little to produce biased judgments. What matters, in our opinion, is the fact that the auditors' reports are influenced, stronger or weaker, by financial incentives. The conclusion supports the idea of an audit that is not paid by the audited firm.

"The strength of partisan affiliations has an important moderating influence on the degree to which people's private beliefs are swayed in the direction of a partner's interests", and "The accountability relationship, rather than financial incentives, proved the stronger influence on judgments"<sup>15</sup>. In addition to financial incentives, there exist psychological factors of which even the auditors are not aware. Both categories affect the independence of financial audit.

## **Method and Data**

The second experiment by Moore et al. (2003) takes into account the scientific results of a sample of the following three categories of auditors: fixed paid, paid for performance and interested in future business. The conclusions refer to these categories and reflect the connection between auditors' decisions and financial incentives. Financial incentives strongly influence the decisions of auditors in the "fixed paid" and "paid for performance" categories. It is also demonstrated that auditors interested in future business with clients may issue an influenced opinion.

We also consider the results when the sample is compounded by the two groups "for payment" and "not at all paid" by auditor clients.

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<sup>15</sup> Moore, D. A.; Loewenstein, G.; Tanlu, L.; Bazerman, M. 2003. Auditor independence, conflict of interest, and the unconscious intrusion of bias. Allston, MA: Division of Research, Harvard Business School. <http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.9.2829&rep=rep1&type=pdf>

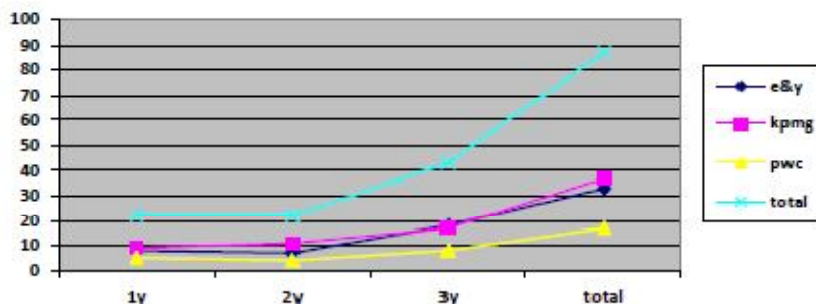
The first group is formed by the three firms from the Big Four, which are active on the Romanian audit market, and the second group consists of the Romania Court of Accounts. The representatives of the Big Four exercised financial audit, having been paid on the basis of the contract with their clients, whereas the audit of the Court of Accounts is not at all paid by the clients and there is no contract between them. Relying on the cited researcher findings, particularly those by Moore et al. (2003), and performing an analysis on our samples and on the public information, we suggest a strong influence from the moneyed relations on the financial audit opinion. Furthermore, we believe that eliminating money from the relation between the auditors and the audited is not only possible but also an objective necessity to improve financial audit independence.

We gathered data from the audited companies' sites in the case of Ernst and Young, KPMG and PricewaterhouseCoopers and from the annual public report of The Court of Accounts.

In the past three years, as shown in Table 1, those three firms audited 180 companies in Romania. However, because we found the financial reports from the sites of only 87 audited companies, the sample is taken from this number.

From an analysis of the information in Table 1, one may conclude the following:

- Despite the fact that we found the audit reports for only 48 percent of all those reported to be audited, we consider this number satisfactory for drawing conclusions. Each of the three auditing companies audited a certain number of entities in each surveyed year from 2009 till 2011. The number of audited entities differs only slightly for each year and therefore does not affect our conclusions.
- The "Big Four" firms audited essentially the same entities for two or three years.
- Of the 87 audited entities, 43 were audited for three consecutive years, 22 were audited for two years and 22 were audited for one year. Overall, more than 74 percent of the audited companies received an audit opinion for two or three consecutive years.
- The number of the "for one year" audited companies is much lower than the "for three years" companies, indicating the preference and the care of the audit companies in preserving the clients' portfolios. The increasing trend from the one year to the three years can be observed in Figure 1.

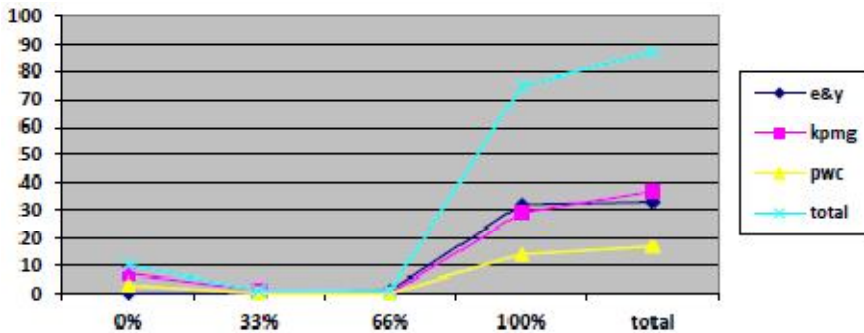


**Figure 1: The Evolution of the Number of Audited Entities within Three Years**

- No audit company suggests a different trend from that of the whole. All of the companies audited the largest percentage for two or three years and only a small percentage represent entities from the “for one year” category. Therefore, auditors’ interest in retaining business with the same companies is strong and almost generally notable, although it is uncertain whether money is the only cause.
- Data from the Court of Accounts are not included in this table because this institution audits the same state agencies, every year, and nearly the same number. It has no contractual obligation to its clients. Therefore, in this case, the number of entities audited is not relevant for our study purpose.

To document the interest of the audit companies for preserving the portfolio of the clients by auditing the companies for consecutive years, we analyse data from Table 2 that reveals the connection between the number of audited years and the financial audit opinion. The following observations can be made:

- All the audit companies, as a whole, issued a clean audit report for all audited years (one, two or three) in 86% of cases. In this percentage are included the majority of entities that were audited three consecutive years and the majority of those from the group of two years.
- Only nearly 12% of the cases refer to the entities that received a modified report for all the audited years. There is one case with a modified report in one year from three audited years and another case with a modified report in two years from three audited years.
- The trend shows an increase in the percentage of clean reports in the case of the companies audited for two and three years, as shown in Figure 2.



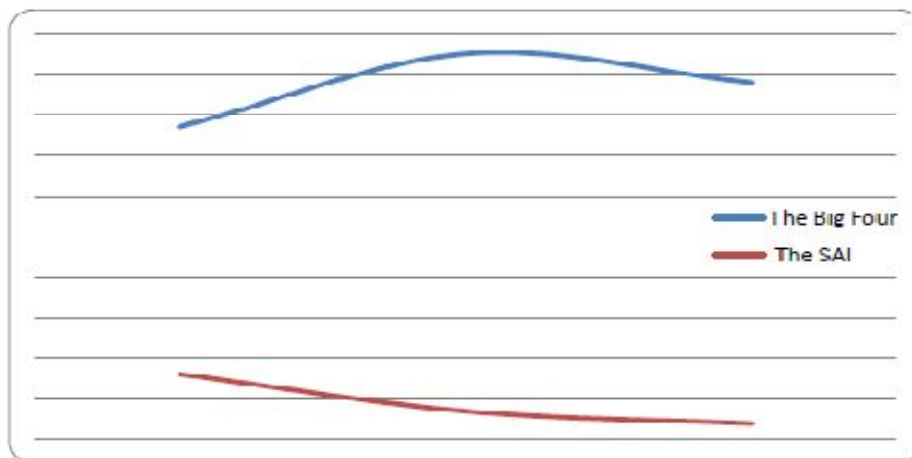
**Figure 2: The Evolution of the Granting Process of Favourable Opinion**

- Auditors could be tempted to issue a clean audit report to improve the relationship with clients. It is also possible that a portion of the clean reports were issued without any interest and simply reflect a positive reality in certain companies. However, the size of the sample of companies with clean reports is large enough to make us believe that a connection exists between the type of audit opinion and the number of audited years at the same companies. It matters less whether it is a proportion or whether this factor is proportionally larger or smaller among others. In future research, we will calculate the contribution of all the factors. The simple fact that such a subjective factor could exist leads us to believe that the independence of financial auditing might be improved by eliminating such an incentive for audit companies to audit firms in consecutive years.

The connection between the type of the financial audit opinion and the audit companies' interest in keeping the portfolio of the clients to maintain or increase revenue appears more obvious if we separate and calculate the number and the proportion of each category from the whole. We examined the proportions of the modified report in the total reports for the "three years audited" and similarly for each category and compared them with figures from the Court of Accounts. The Court of Accounts, and, respectively the SAI, audits public resources and uses the INTOSAI's audit standards, which are fundamentally similar to IFAC standards. The SAI has no contractual or material connections with those that are audited. The audit is conducted by auditors who are completely independent from the audited entities and are paid from sources other than from the audited entities' budget. In addition, there is no interest in preserving the portfolio of the clients because they remain the same each year. The data in Table 3 suggest the following:

- The two specific groups of audit companies include Ernst and Young, KPMG, and PricewaterhouseCoopers in one group and the Court of Accounts in another group. In the past three years, the former group audited 87 entities as follows: 43 for three consecutive years, 22 for two years and 22 for only one year. Each year, the Court of Accounts audited 1510 entities, which represented nearly the same number and the same entities every year. This figure is comparable to the 43 of the first group because the data refer to the same content, namely, the number of entities audited for three consecutive years.

- The first group that audited 43 entities for “three years” issued an unmodified report in 88.37% of them and only 11.62% received a modified report. In the case of the Court of Accounts, from the 1510 entities audited for three consecutive years, merely 4% received a favourable opinion (unmodified report) and for the rest of the 96%, the reports were modified because of material misstatements. The trend is the same in the case of the category “for two years”. The two groups demonstrate a large difference, as shown in the following two figures.



**Figure 3: The Differences concerning Granted Unmodified Report (Trend and Gap)**

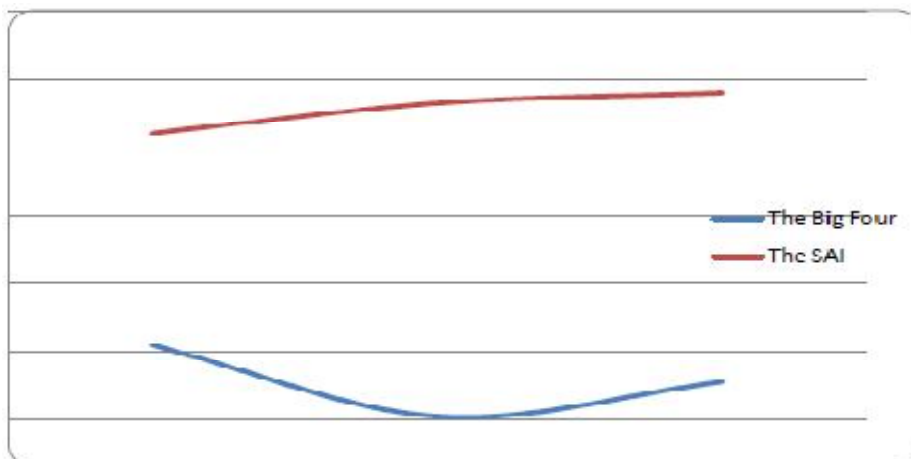
- The unmodified report percentage in all three years is much lower in the case of the SAI, which at most is nearly 20%, compared with the percentage of the Big Four, which is more than 80%. The percentage of the unmodified report in the case of the SAI tends to decrease whereas the Big Four’s trend shows an increase.

That finding suggests that there exists a possible temptation of the Big Four to connect the audit opinion with an interest in maintaining the portfolio of the clients.

- Concerning the modified opinion, Figure 4 also suggests a large gap between the two groups. The large percentage of modified opinions in the case of the SAI, between 80 and 100, in our opinion might reflect the lack of any material interest of this auditor to its clients. The percentage of the modified opinion is very small, between 10 and 20, in the case of the Big Four. Among the causes is a material interest in either being aware or unconscious.

- The trend of the two groups, showing an increase in the percentage of the modified report from one to three years in case of the SAI and a decrease in the case of the Big Four, confirms the particularities as far as the behaviour of these two auditors is concerned.

- We believe there is not a strong need for evaluating the contribution of this factor to the size of the gap. Numerous researchers have already demonstrated the particularities of the auditors' behaviour in different circumstances. In this context our findings are consistent with the results of other scientific researchers, particularly Moore et al. (2003).



**Figure 4 : The Differences Concerning the Granted Modified Report (Trend and Gap)**

- In the case of the group of audit companies, the largest percentage (22.72%) of the modified report (unfavourable opinion) refers to the category of "for one year" audited companies, whereas in the Court of Accounts' case, the percentage of the modified reports for the audited companies is relatively the same at 96% for "three audited years", 93% for "two audited years" and 84% for "one audited year". The Court of Accounts appears consistent in issuing modified reports, whereas the companies that conduct financial auditing (the first group) show a large percent of unmodified reports for the "three- and two- year audited entities". The group also demonstrates a larger percent of modified reports in the category of "one year audited"; that is, 22% compared with 4.54% and 11.62% for the other categories, respectively.

- Notably, the audit companies have a large proportion of unmodified reports, between 82.35% and 94.44% in the case of entities audited "for three years". This result could indicate a common behaviour in connecting the type of the audit report with the financial interest.

In our opinion, the most important conclusion from this analysis is that the Court of Accounts having more independence was not connected to its decision on the financial statements of the audited entities and its financial needs. However, as the figures show, the audit companies are interested in keeping clients for additional years, ensuring that their revenue is stable. For that reason, the majority of these firms reject the principle of rotating auditor assignments. As the data and the published information show, the audit companies are tempted to use their lever of "audit opinion" to maintain clients and to achieve their financial targets. These conclusions are consistent with the results of previous scientific research concerning the behaviour of financial auditors, as presented in the first chapter.

## **Discussion and Conclusions**

Because of the independence of the Court of Accounts, its opinions on financial statements are different from the audit companies, which might have a real interest in issuing unmodified opinions.

Regarding the internal rules of the Court of Accounts, the accountability and financial discipline appear to be different in the case of the state companies from the private companies that are primarily audited by the representatives of the Big Four. In our opinion, all the companies, whether state-owned or privately organised, perform their activity in the same country in which the laws are the same for everyone and in which fiscal evasion, corruption and temptation to easily gain money are the same throughout the country.

In explaining the difference between the Court of Accounts' percentages and the audit companies' percentages, there is also a need for more accuracy regarding the proportion that the factor that we describe affects the percentages. In other words, audit companies' interest in maintaining clients is not the only factor that explains such a large gap. Other factors include the following: the different internal rules of the auditors, certain positive behaviour of foreign audited companies, the difference between public and private money and professionalism in complying with the international standards of audit.

However, one cannot exclude the factor of the material interests that influence the behaviour of the auditors as demonstrated in numerous previous studies.

Future work will offer a larger sample, particularly examining more relevant SAI activity and a model for singling out this factor contribution.

However, we believe that the actual results are sufficient for considering that the independence of financial auditing is affected by the material interests of the financial auditors. The results are also consistent with previous research and therefore lead to several proposals. The Big Four are the same throughout the world and as a result their auditors' behaviour is similar to that I demonstrated. The SAI is also working similarly in Romania and in any other countries. Therefore my conclusions can be considered an increment both theoretically and practically.

## **Proposals**

The Romania Court of Accounts, similar to nearly all SAIs, is a good example of the independence of financial auditing. The INTOSAI standards cover all the necessary guidelines for auditors and are fundamentally similar to those of IFAC.



We demonstrated that the independence of such an institution is not affected by the material interests as it is in the case with the “Big Four” as audit companies. Our proposal aligns with the introduction of a rotation principle in the auditors’ assignment or with the establishing of a special audit mission for large companies, banks and other financial institutions. The special mission refers to financial audits conducted under the same conditions of independence as that of SAIs.

The European Commission’s green paper refers to such approaches but received an elegant “not” in the response from the IFAC. In this respect, we consider that it is worth making an attempt, ignoring the fear of bureaucracy or the mitigation of the audit services quality that IFAC claimed.

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**Table 1: The Audit Situation for the Past Three Years (2009-2011)**

Nr. Crt.	Audit company name	The number of entities published	The number of audited entities Nr./%	The number of audited entities for 3 consecutive years Nr./%	The number of audited entities for 2 consecutive years Nr./%	The number of audited entities for 1 year Nr./%
1	2	3	4	5	6	7
1.	Ernst and Young	59	33 (55.93 %)	18 (54.5%)	7 (21.2%)	8 (24.2%)
2.	KPMG	78	37 (47.43%)	17 (45.9%)	11 (29.7%)	9 (24.3%)
3.	PWC	43	17 (39.53%)	8 (47.05%)	4 (23.5%)	5 (29.4%)
	TOTAL	180	87 (48.33%)	43 (49.4%)	22 (25.3%)	22 (25.3%)

Drawn by the author

**Table 2: The Granting of Favourable Audit Opinions**

Nr. Crt.	Audit company name	Total audited	Entities with 100% favourable opinions	Entities with 66% favourable opinions	Entities with 33% favourable opinions	Entities with 0% favourable opinions
1.	Ernst and Young	33	32 (96.96 %)	1 (3.03%)	0	0
2.	KPMG	37	29 (78.37%)	0	1 (2.70%)	7 (18.91%)
3.	PWC	17	14 (82.35%)	0	0	3 (17.16%)
	Total	87	75 (86.20%)	1 (1.14%)	1 (1.14%)	10 (11.49%)

Drawn by the author

**Table 3: The Connection between the Audit Opinion and the Audited Period**

Nr. Crt	Audit company name	Total audited entities	Total audited entities for three consecutive years	The number of entities with unmodified report Nr./%	The number of entities with modified report Nr./%	Total audited entities for two consecutive years	The number of entities with unmodified report Nr./%	The number of entities with modified report Nr./%	Total audited entities for one year	The number of entities with unmodified report Nr./%	The number of entities with modified report Nr./%
0	1	2	2.1	2.1.1	2.1.2	2.2	2.2.1	2.2.2	2.3	2.3.1	2.3.2
1	Ernst and Young	33	18	17 (94.44 %)	1 (5.55%)	7	7 (100%)	0	8	8 (100%)	0
2	KPMG	37	17	14 (82.35%)	3 (17.64%)	11	10 (90.90%)	1 (9.09%)	9	6 (66.66%)	3 (33.33%)
3	PWC	17	8	7 (87.50%)	1 (12.50%)	4	4 (100%)	0	5	3 (60%)	2 (40%)
	TOTAL	87	43	38 (88.37%)	5 (11.62%)	22	21 (95.45%)	1 (4.54%)	22	17 (77.27%)	5 (22.72%)
	CCR*		1.510**	63 (4.17%)	1.447(95.82%)	1.510***	126 (8.34%)	1.384(91.65%)	1.510***	235 (15.56%)	1.275(84.43%)

\*The Public Report on 2011, [www.curteadeconturi.ro](http://www.curteadeconturi.ro)

\*\* Data processed by the author relying on the Public Report and considering the specific audit activity of the Court of Accounts in the public area.

\*\*\*The figures are approximated.

*Drawn by the author*