

CIVIL RESPONSIBILITY IN AUDIT. AN OBJECTIVE NECESSITY OF ECONOMIC REALITY

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Abstract:

Nowadays, we can feel ever more the need for the auditors to take on responsibility in order to express a motivated opinion on the clear and complete true and fair view, of the financial position of the patrimony of the financial situation and of the results obtained by the audited entity. Statutory auditors or auditing companies answer for any damage caused as a result of negligence in performing their mission. If errors are found in the financial statements, the auditor is responsible both in front of the users of the information that was made public and of the managers of the company that hired them. The purpose of this study is to analyze the manner in which an auditor's inability to perform their audit activity may lead to taking civil responsibility, or, moreover, to requesting damages from the audit company or from the independent auditor.

Key words: *audit contract, negligence /imprudence during the mission, civil responsibility, deviation, sanctions.*

JEL classification: M41, M42, M48

INTRODUCTION

The current global financial crisis has intensified enduring discussion in the professional accounting and related financial press over the equitable nature of auditor responsibility and the potential risk that a successful lawsuit against the auditors of a collapsed bank or financial services institution could serve to bring down one of the four largest audit firms (Talley, 2006; Zubli, 2007; Spence, 2009).

The good functioning of capital markets requires sufficient audit ability on the long run and a competition market for audit services, which would include a sufficient number of audit companies that can and will perform legal audit missions for the enterprises whose floating assets are allowed to be traded on a regulated market in a member state. Nevertheless, the growing instability of market capitalization of the enterprises has resulted in risks concerning higher liability, while access to insurance against the risks associated to this type of audit has become ever more restrained (the Official Journal of the European Union, June 2008).

Statutory auditors or audit companies are liable for any damage caused as a result of negligence in performing their mission. Moreover, an audit company is liable together with the statutory auditor who performed a mission in its name, for any damage caused.

The fact that the missions specific to this type of audit are almost always accompanied by risks has determined lawmakers to foresee and regulate certain aspects concerning the legal liability of the auditor, the applicable sanction regime, as well as the limitation of the auditor's liability in what concerns the occurrence of caused prejudice (Costuleanu, Horomnea, et al., 2011, pp. 41-50). If after the completion of the audit mission it is noticed that the financial statements are incorrect, the auditor is liable both to the users of the information made public and to the managers of the entity that hired them. Without a doubt, auditors are liable in respect to the psychological impact caused for the users of the information they verify.

1. AUDIT, A MAIN FACTOR OF FINANCIAL COMMUNICATION

From our perspective, audit is the piece of reference of honest financial communication. Both the investors and the other stakeholder categories (users of financial-accounting information) need independent insurance concerning the sincerity and regularity of the accounting information in the annual financial statements. Based on these, the policy makers decide whether or not: to sell or buy the floating titles launched on the market; to dispose the development, consolidation, and amortization in a certain rhythm of the invested capital or to dissolve the business; extend or restrain, lower or increase the cost of the granted credit; set their workplace, the necessary supplies, the continuity of the collections and payments, etc.

Statutory audit, as a supporter of public honesty and liability, involving the *contractors or clients*, on the one hand, and the *auditors* who accepted the mission on the other, became an objective necessity of the reality of the world we live in, and essential factors for the good development of economic life. *Accounting professionals* have an extremely difficult task, which is to favor transparency. For this reason, they need to take on certain risks (economic failure, audit failure, audit risk), which determines the need to perform the audit mission in the conditions of assuming civil liability and, moreover, the responsibility to detect significant erroneous presentations caused by fraud.

If the auditor does not perform the accepted audit mission rigorously and professionally, then the result is an *audit failure*. This occurs when the auditor expresses an erroneous audit opinion as a consequence of a primary failure to comply with audit standards (Arens, Loebbeck, 2006, p. 134).

In such cases, the law allows the involved parties that have suffered losses as a result of the auditor's non-compliance with the audit mission to recover a part of all of the losses directly caused by this situation. What is certain is that no way of exactly determining the degree of rigorousness or competence in the auditor's performing their mission has been yet found, as a result of the complexity of this activity. However, the inability of an auditor to perform their audit mission may lead to a certain degree of liability, and, moreover, to the audit company or independent auditor being requested to provide compensations.

Under these circumstances, the connection between profitable financial management, the transparency of the shares, transformations, and movements, of the results and accumulations within entities becomes obvious. The accounting professional, be they an accounting expert, an auditor, or a fiscal consultant, must be liable for every aspect of their work in the field of accounting and audit. For example, if out of carelessness or negligence, an accounting expert has not drawn and filed the fiscal statements of a client in time, they can be held liable for any penalties or interests that the client must pay, plus the fees applied for drawing the fiscal statements. In certain states, the courts may condemn the accounting expert to also pay pecuniary damages.

Moreover, the need to identify solutions for improving the quality of the information has recently become essential for the world's economic life, in the conditions in which the fulfillment of this desideratum would determine the reliability of financial communication. The importance of the accounting professionals, and especially the auditors, to become liable is obvious in order to formulate relevant opinions, in accordance with reality and reflecting a faithful accounting image, in compliance with the standards.

Conflicts between the users of the financial statements and the auditors occur frequently because of the disparity between the users' and the auditors' expectations. Most auditors consider that fulfilling the audit mission in accordance with general audit

standards is what is expected from them, while the stakeholders consider them as warrantors of the accuracy of the financial statements made public. In these conditions, it is very important for the accounting profession and especially audit to clarify the mystery surrounding their role and objectives, first of all, and secondly to clearly present audit failure to the people who contract them in the mission.

2. REGULATION OF CIVIL LIABILITY IN AUDIT AND IN ACCOUNTING IN THE UNITED STATES OF AMERICA AND IN ROMANIA

Along the years, in the United States of America, especially, the most important evolution in the field of litigations concerning the civil liability of accounting professionals has been recorded in trials initiated within the federal legislation concerning value titles. This is mainly due to the fact that the legislation concerning value titles includes strict mentions regarding the liability of accounting professionals.

Probative in this sense is the **Law on value titles of 1993**, which refers to the information included in the reports presented by trading companies for recording to stock exchanges, the only one that stipulates the legal obligation of the defendant to bring evidence to their defense. This law is particularly harsh in what concerns the auditors, and it even includes a distinct section, 11, dedicated to the rights of the auditors and of the third parties.

Some of the provisions concerning this subject are presented in what follows (Arens, Loebbeck, 2006, p.145):

- Any third party that purchased value titles has the right to prosecute the auditor in case forgeries or significant omissions exist in the audited financial statements;
- The user, as a third party, does not have the obligation to prove that they relied on incorrectly audited financial statements or that the auditor was careless or committed a fraud while performing audit; they must only prove that the financial statements include significant errors.
- The auditor has the obligation to defend themselves by proving that they have performed quality audit or that the petitioner's losses are caused by other factors than deceiving financial statements.

Moreover, the auditor is responsible for the correctness (quality) of the financial statements in order for them to reflect a faithful accounting image, even after the end of the fiscal year, until the date when the registration documents with stock exchange authorities become applicable, an event that may occur even after several months.

For example, if the audit report was drawn on March 1st, 2012, the financial statements were closed on December 31, 2011, and the date of the registration file is August 1st, 2012, the auditor must verify the operations performed until the date of the audit report, which is March 1st, 2012. In the case of documents concerned by the 1933 Law, the auditor must verify all the operations performed until the date when the file was registered, which is August 1st, 2012.

In Romania, according to the Decision of the Council for the Public Supervision of the Statutory Audit Activity No. 17/2010 for the approval of the *Regulation concerning the limitation of the civil liability of the statutory auditors and of audit companies*, published in the Official Monitor no. 176/14.03.2011, the civil liability of the statutory auditor or of the audit company for the prejudices caused through an indirect intent or on purpose, during the execution of the audit contract or in connection to it, is limited to:

- The payment of 3 audit fees established in the audit contract, by the client to the statutory auditor or to the audit company, in accordance with the provisions of the audit contract, whose object is the statutory audit of the

annual financial statements of a trading company that is not included in the category of public entities, or

- The payment of 5 audit fees established according to the audit contract, by the client to the statutory auditor or to the audit company, in accordance with the provisions of the audit contract, whose object is the statutory audit of the annual financial statements of a public entity.

The amount of the previously mentioned damages is the maximum cumulated limit corresponding to all the prejudices caused as a result of the statutory audit mission based on the same audit contract, which the statutory auditors or audit companies should pay irrespective of the number of prejudiced persons or to the total amount of the alleged prejudices caused. Moreover, the civil liability of the statutory auditor or of the audit company for the caused prejudices is not solidary to that of the other authors of the illicit actions that caused the prejudices, if any.

The limitation of the liability of the statutory auditor does not apply in case it is proved that the non-fulfillment of their professional duties was made with a direct intent. The sanctions applied must be effective, proportional and discouraging for the statutory auditors and to the audit companies in case that the statutory audits are not performed in accordance with the specific normative frame. At the same time, the sanctions applied must not affect the civil liability regime, and the measures taken or the sanctions imposed to statutory auditors and to audit companies need to be presented in an appropriate manner to the public.

3. DIRECTIONS OF ACTION OF CIVIL LIABILITY IN THE FIELD OF AUDIT

According to ISA 200, “*General objectives of the independent auditor and the performance of audit in accordance with the International Audit Standards*”, the objective of an audit of the financial statements is to allow the auditor to express an opinion concerning the financial statements, more exactly if they are drawn, under all their significant aspects, in accordance with an identified frame of financial reporting. Audit performed according to ISA is meant to provide a reasonable certification concerning the fact that the financial statements do not include significant distortions caused by fraud or errors.

The fact that audit is performed may act as a prevention of fraud and errors, but the auditor is not and cannot be held liable for preventing them. However, in the planning and performing process of audit procedures, as well as in the evaluation and reporting of audit results, the auditor must take into account the risk of occurrence of significant distortions in the financial statements, as a result of fraud or errors (ISA 240 – The auditor’s liabilities concerning fraud in an audit of the financial statements).

In Romania, audit companies are considered liable, according to the Emergency Order no. 90/2008 concerning the statutory audit of the annual financial statements (art. 32-37), if one of the partners, administrators or employees who is not a statutory auditor intervenes in the independent practice of the statutory auditor profession. This is the case only if the limitation of the civil liability in the field of business auditing risks prejudicing the independence of the statutory auditors who perform this activity in the name of the audit company. Moreover, performing the statutory audit activity without being a statutory auditor is a crime and is punished according to criminal law.

In what concerns investigations and sanctions, the Council for the Public Supervision of the Statutory Audit Activity (CSPAAS) institutes efficient systems for the detection, correction, and prevention of inappropriate statutory audit.

The sanctions applied (according to Chap. VII of the Emergency Order no. 90/2008) must be efficient, proportional, and discouraging for the statutory auditors and for audit companies in case the statutory audits are not performed according to the

specific normative frame. At the same time, the applied sanctions must not affect the civil liability regime, and the measures taken or the sanctions imposed to statutory auditors and to audit companies need to be appropriately presented to the public. As a result, the Chamber of Financial Auditors in Romania applies the following sanctions to auditors and to audit companies: *reprehensions, written warnings, the suspension of the right to perform the statutory audit activity (during a period between three months and a year) and withdrawing the authorization, accompanied by the loss of the capacity of statutory auditor.*

At the same time, the regulation concerning the limitation of the civil liability of statutory auditors and audit companies states that liability is directly related to the occurrence of prejudice caused with direct or indirect intent, or as a result of carelessness or imprudence in performing specific missions. As previously mentioned, this type of liability is limited to the payment of three audit fees established in the audit contract, due by the client to the auditor, in accordance with the provisions of the audit contract, having as object the statutory audit of the annual financial statements of a trading company that is *not* included in the category of public entities. On the other hand, if the object of the audit is a public entity, then the payment limit may amount to up to five fees. It is important to mention that the category of public entities includes credit institutions, insurance companies, entities regulated and supervised by the National Commission of Floating Assets, trading companies whose floating assets are allowed to be traded on a regulated market, national companies and enterprises, legal persons that belong to a group of companies and are included in the consolidation area of a mother-company that applies the IFRS, and legal persons that benefit from irredeemable loans or from loans guaranteed by the state.

From the above statements, we can see that both the independent statutory auditor and the audit company should close compulsory insurance to cover professional risks because of the complexity of economic life and of the risks to which they are subject in performing the audit activity.

CONCLUSIONS

In their activity, accounting experts and authorized accountants are subject to professional risk, to the risk for some works not to be appropriate from a quality perspective and to bring prejudices to their clients. For this reason, accounting professionals, including auditors, must guarantee their civil liability concerning the performed activity, by closing an insurance policy or by paying a contribution to the warranty fund.

No manner of exactly determining the degree of rigorousness or competence that the accounting professionals must use in performing their mission has been yet found, as a result of the complexity of the activity they choose to perform. An auditor cannot obtain an absolute certification concerning the fact that the significant distortions in the financial statements will be detected. Because of the inherent limitations of an audit commitment, there is an inevitable risk for significant distortions of the financial statements not to be detected, although audit is planned and performed appropriately, in accordance with ISA. From another perspective, an auditor's inability to perform the audit activity may lead to a certain degree of liability and implicitly to the audit company or the independent auditor being requested to pay compensations. For this reason, both audit companies and independent auditors must have insurances to cover professional risks.

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