

THE BENEFITS OF POB INSPECTIONS. CASE OF ROMANIA

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Abstract: *The implementation of the inspections program by POBs represents the key reform that has improved the relationship between financial audits under ISA and financial reporting under IFRS. Psychologically, human beings pay more attention in case of supervision. Concerning the European POBs, there is very little written about the effect of POBs on audit quality. In this study we emphasize the benefits brought by POB inspections, highlighting the activity of ASPAAS at the level of Romania. In the end, we draw future research ideas based on POB annual reports and ASPAAS activity.*

Keynotes: *audit, financial reporting, POB inspections, annual reports, supervision.*

JEL codes: M4

Introduction

Over the last decade, the quality of audit services has been debated due to the high number of economic frauds, and a significant number of countries has agreed to set up an independent supervisory authority to verify the national audit profession. The appearance of PCAOB (Public Company Accounting Oversight Board) represents a direct response of the Sarbanes-Oxley Act of 2002 and it represents also a model for all the national POBs (Public Oversight Boards). There are critics who are questioned the expertise and the adequacy of inspections by POBs (Lennox and Pittman, 2010; DeFond, 2010; Church and Shefchik, 2012; Peecher et al., 2013).

Despite all the discussions, the introduction of POB is one of the main reform aimed at improving audit quality (Kieso et al., 2020). Concerning the impact of PCAOB, the emerging literature (Lennox and Pittman, 2010; Carcello et al., 2011; Gunny and Zhang, 2013; DeFond and Lennox, 2017) argues that its effect on audit quality remains a consistent empirical question. Most specialized studies that analyze the effects of POB inspections focus on the US PCAOB authority. Lamoreux (2016) shows the direct effects of PCAOB inspectors of the US companies on audit quality as measured by less earning management and more reported material weaknesses with higher predilection to issue going concern overview.

This paper is organised as follows. The first Section introduces the main cues of this paper. Section II provides relevant information about the background and the actual context of POBs inspections. In Section III, we gather information about ASPAAS (Authority for Public Supervision of the Statutory Audit Activity) annual inspections and their activity and Section IV encloses conclusions and personal implications.

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Literature Review

There is little evidence on the impact of POBs on audit quality, regarding the European countries. As an example, Carson et al. (2017) find a positive effect of POBs' inspections on the quality of auditing. However, there is no systematic documentation concerning the effect of inspections commence, inspection characteristics and disclosing the results of national inspections.

Despite the real benefits of POBs, the public oversight of the auditing profession is still the subject of skepticism (Church and Shehchik, 2012; Westermann et al., 2019) for the limited expertise and insufficient transparency of procedures (Glover et al., 2009). More, the inspection program is claimed being largely ineffective (Johnson and So, 2018) and non-representative for the entire client portfolio (Peecher et al., 2013). Certainly, the uncontested advantages of public oversight argue the further academic research on this subject. Early studies ensure descriptive evidence on the effects of PCAOB inspections and audit quality. Lamoreaux (2016) argues the positive association between PCAOB inspections and audit quality measured by less earnings management and more reported material weaknesses. Krishnan et al. (2017) find that PCAOB inspections are associated with lower abnormal accruals in the post-inspection period. Specialized literature (Aobdia and Shorff, 2017) attest the previous findings related to the association between PCAOB inspections and audit quality. Some exceptions (van Opijnen et al., 2016; Carson et al., 2017) documents the public oversight of the audit regulation in the context of audit quality and auditor independence. In the same context, Hanlon and Shroff (2020) document about the number and frequency of inspections by POBs influence the inspection feedback of the analysed auditors. Florou and Shuai (2020) find that the audit costs grow for clients of inspected auditors if the national inspections are independent, rigorous and complex. Carson et al. (2017) shows that inspection commence and the inspection characteristics increase the audit quality and its effect is more pronounced for clients of Big 4 auditors who become subject to national inspections, than for clients of non-Big 4 auditors. Also, the specified literature related to PCAOB attests the role of public oversight into audit quality (Khurana et al., 2021).

Our study documents the benefits of POB inspections by emphasizing the role of the POB annual reports and through ASPAAS activity. At the end, some personal consideration will be drawn based on POB annual reports and ASPAAS activity.

The annual activity of ASPAAS

As a normative act, the activity of ASPAAS is regulated by Regulation (EU) No. 537/2014 of the European Parliament and of the Council of April 16, 2014 on the specific requirements regarding the statutory audit of public interest entities and the repeal of Commission Decision 2005/909/EC, Directive 2014/56/EU of the European Parliament and of the Council of April 16, 2014 amending Directive 2006/43/EC on the legal audit of annual financial statements and consolidated financial statements, and the national Law no. 162 of 07/06/2017 regarding the statutory audit of the annual financial statements and the consolidated annual financial statements and the amendment of some normative acts.

In accordance with Art. 35 (4) letter i of Law 162/2017, a summary of the inspection results is published annually on the website of ASPAAS. Thus, on the ASPAAS website there is a summary of the annual reports for the period 2018-2021, and for the year 2022 there is still no information published on the website. In what follows, we would like to highlight the ASPAAS activity, for each year separately, in order to observe an increase/decrease of the number of inspections and of the applied sanctions.

In 2018, the number of the inspected firms is not publicly disclosed. In this vein, some data atests the total number of the identified issues. The fewest irregularities are found at the level of ISA 570.

Table 1: ASPAAS inspections in 2018

No.	ISA verified	Domeniu	No of identified issues	Percentage
1	ISQC, ISA 220	Internal control system	11	7%
2	ISA 300, ISA 250	Planning	13	9%
3	ISA 500, ISA 520, ISA 530, ISA 501, ISA 505, ISA 540	Audit evidence, External confirmations	111	74%
4	ISA 550	Related parties	3	2%
5	ISA 260	Communication with the governess	4	3%
6	ISA 580	Completion of the audit	2	1%
7	ISA 700, ISA 701, ISA 706	The audit report	4	3%
8	ISA 570	Business continuity	1	1%
	TOTAL		149	100%

Source: ASPAAS 2023

In 2019, the number of the inspected firms is not publicly disclosed. The level of motivation, for the audit firms inspected by national POBs, is higher in order to improve the quality control system and the periodic inspections can provide incentives for auditors. In this vein, some data atests the total number of the identified issues. The fewest irregularities are found at the level of ISA 550.

Table 2: ASPAAS inspections in 2019

No.	ISA verified	Domeniu	No of identified issues	Percentage
1	ISQC, ISA 220	nternal control system	170	36%
2	ISA 300, ISA 250, ISA 315	Planning	59	13%
3	ISA 500, ISA 520, ISA 530, ISA 501, ISA 505, ISA 540	Audit evidence, External confirmations	167	35%
4	ISA 550	Related parties	1	0%
5	ISA 260	Communication with governance	12	3%

6	ISA 580	Written statements	4	1%
7	ISA 700, ISA 701, ISA 706	The audit report	31	7%
8	ISA 570	Business continuity	3	1%
9	ISA 210	Agreement on the terms of the mission	11	2%
10		Other aspects	13	3%
	TOTAL		471	100%

Source: ASPAAS 2023

In 2020, the total number of the inspected firms is 26. In this vein, some data attests the total number of the identified issues. The most irregularities are found at the level of ISQ, ISA 220.

Table 3: ASPAAS inspections in 2020

No.	ISA verified	Domeniu	No of identified issues	Percentage
1	ISQC, ISA 220	Internal control system	227	34%
2	ISA 300, ISA 250, ISA 315, ISA 230, ISA 330, ISA 530	Planning	87	13%
3	ISA 500, ISA 520, ISA 530, ISA 501, ISA 505, ISA 540, ISA 230	Audit Evidence, External Confirmations, Audit Documentation	238	36%
4	ISA 550	Related parties	2	0%
5	ISA 260	Communication with governance	22	3%
6	ISA 580	Written statements	8	1%
7	ISA 700, ISA 701, ISA 706	The audit report	6	1%
8	ISA 570, ISA 560	Going concern and subsequent events	19	3%
9	ISA 210	Agreement on the terms of the mission	20	3%
10		Other aspects	39	6%
	TOTAL		668	100%

Source: ASPAAS 2023

In 2021, the total number of the inspected firms is 10. In this vein, some data atests the total number of the identified issues. The most irregularities are found at the level of ISA 500, ISA 520, ISA 530, ISA 501, ISA 505, ISA 540, and ISA 230.

Table 4: ASPAAS inspections in 2021

No.	ISA verified	Domeniu	No of identified issues	Percentage
1	ISQC, ISA 220	Internal control system	19	33%
2	ISA 300, ISA 250, ISA 315, ISA 230, ISA 330, ISA 530	Planning	7	12%
3	ISA 500, ISA 520, ISA 530, ISA 501, ISA 505, ISA 540, ISA 230	Audit Evidence, External Confirmations, Audit Documentation	23	40%
5	ISA 260	Communication with governance	1	2%
8	ISA 570, ISA 560	Going concern and subsequent events	3	5%
9	ISA 210	Agreement on the terms of the mission	2	3%
10	Alte cerințe specifice prevăzute de Legea nr. 162/2017 și Regulamentul (UE) 537/2014	Other aspects	3	5%
	TOTAL		58	100%

Source: ASPAAS 2023

More, taking into consideration all the analysed years, some identified issues continues to record values, giving as some exemples: ISA 500, ISA 520, ISA 530, ISA 501, ISA 505, ISA 540, and ISA 230.

Summarinsing all the above, it is difficult to write down some unitar conclusions taking into consideration that for 2018 and 2019 the number of the inspected firms by our national POB is not disclosed. Also, even if the number of the identified issued is increasing in time the authority ASPAAS continues to decrease the inspected sample. In this sense, the number of the audited firms in 2021 in only 10.

Conclusions

Despite the real benefits of POBs, the public oversight of the auditing profession is still the subject of some polemics at the level of specialized literature. Through this study, we emphasize the benefits of POB inspection and the impact of the annual activity of national POBs, particularly – ASPAAS, among which we want to mention: (i) in case of audit deficiencies, the enforcement process or sanctions imposed by national POBs can influence the level of audit quality, (ii) psychologically, human being pay more attention in case of supervision, (iii) the level of motivation, for the audit firms inspected by national POBs, is higher in order to improve the quality control system and the periodic inspections can provide incentives for auditors, (iv) other audit firms can improve audit quality by not repeating the same errors as the detected audit firms, and (v)

disclosing the detected shortcoming to audit firms, the auditors can learn from the received feedback.

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