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### Approaches Regarding the Application of ISQC1 and ISA 220 in the Audit Activity

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## Approaches Regarding the Application of ISQC1 and ISA 220 in the Audit Activity

Riana Iren RADU<sup>1\*</sup>, Iuliana Oana MIHAI<sup>2</sup>

### *Abstract*

*In the context of global change, the financial crisis is highlighting how financial systems are connected. This interconnection brings more prosperity but at the same time a greater concentration of systemic risk. Policy makers are also responsible for the economic impact of the crisis and for legislative changes at the request of the user audience. In this paper the authors proposed to express a point of view on the importance of creating audit reports in order to ensure access to the structural funds, but especially the importance of including in the prepared reports of other information about the entities that access these funds and not just financial information. The author believes that this information would outline a more complete overview of the entity and ease the evaluations for reimbursement by the contracting authority.*

**Keywords:** *audit, founds, quality, standards, services.*

**JEL code:** M42

### 1. Introduction

The professional ethical code of the auditor determines that the objectives of financial audit must meet the highest standards of professionalism, reaching the maximum level of performance in order to maintain the level of confidence of users in the profession of financial auditor and to meet the needs of the public interest.

The Code of Ethics sets out five fundamental principles of professional ethics and elaborates the conceptual framework for their application. Members of the audit profession must implement the conceptual framework to recognize threats, in accordance with fundamental

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principles, to assess their importance and to apply appropriate security measures to eliminate or mitigate risks so that compliance with the fundamental principles is not compromised.

The members of the audit profession must comply with the fundamental principles developed in the Code of Ethics and Professional Conduct (integrity, objectivity, professional competence). The current economic thinking implies that individuals always continue their own interest based on economic incentives and therefore ignore the influence of ethical motivation, such as sympathy and public interest, on human action [1]. Auditors have the responsibility for confidentiality and are required by law, if it is in the public interest, to disclose relevant details about the client audited to third parties.

The general principles of an audit mission take into account that in carrying out a mission, the auditor will comply with the ethical requirements in force specified in the Code of Ethics for Professional Accountants (ISA 200, paragraph 4). In other news, senior management is responsible for correctly reflecting accounting information in financial statements [2].

A professional in the field of economics can translate into the role of an ethical leader in his field from the point of view of professional behavior in an economy with social bases. According to Weber and Bulgakov, economic freedom is grounded in its social wishes [3].

It can be said that in the audit planning process, it is necessary to consider the following elements in order to prepare the general audit strategy and an appropriate audit plan.

In order to indicate the location and importance of audit evidence in the audit activity, the purpose of the audit should be taken into account: the auditor should provide an opinion on how the financial statements are prepared in all relevant aspects and whether they are in agreement with the financial reporting framework.

It has been observed in the current economic thinking, minimal involvement of professionals in social relations and economic history, more precisely, in relationships that continue the precursors and the theories of precursors in the current ethics. In this context, the ethical framework becomes amorphous, with tendencies in punctual responses to punctual challenges, and ethical principles become part of a legislative framework. [4]

The auditor's liability for subsequent events may be retained in other audit engagements, other than assurance engagements, if these engagements refer to current periods, and if there are such events between the reference date and the date of issue of the report. [5]

Public interest is at the main focus for the auditing profession. Taking a general look at it, three key topics can be highlighted- professional

skepticism, quality control, and audit groups. For the purpose of doing such activities, the most important part is the audit standards that underlie these three issues and the desire for harmonization at global level. Under its public interest mandate, IFAC contributes to the development, adoption and implementation of high-quality international audit and assurance standards, primarily by supporting the International Standards on Auditing and Assurance (IAASB). [6]

According to Jose Gaspar, the role of economic geography leads to fundamental motivations, which generate economic theories with applicability in the uniformity of accounting concepts, in order to implement standards on a broader economic area. [7]

## 2. Research methodology

The paper presents a complex analysis of the quality technical audit based on the current ISQC1 and ISA 220 standards. The approach of the analysed aspects is a descriptive analytic based on the study of the specialized literature with practical aspects highlighted by case studies at the end of each chapter of the paper.

At the conceptual level, the audit role was presented in the macroeconomic environment. This role is a strong one in countries with experience in the use of audit practices. In Romania, in the context of alignment with International Standards, over the past 15 years, the audit has grown as a source of distortions at present with some restrictive legislative provisions and current changes in tax codes and accounting standards / IFRS.

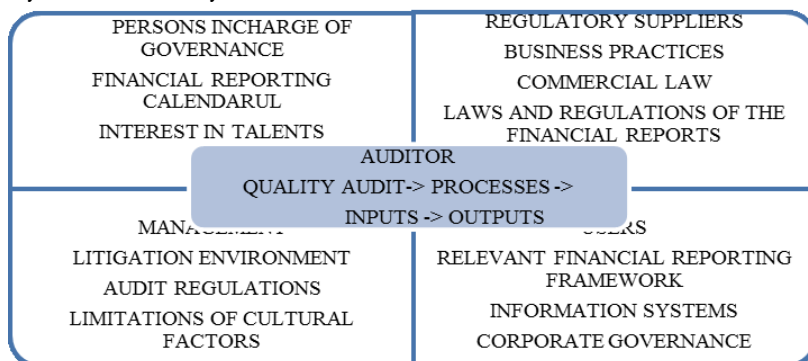
The presentation of the quality control system has shown that it is made up of policies designed to achieve the objectives by which the firm and its staff comply with the applicable professional and legal standards.

A number of issues that need to be resolved in the near future will be identified by statistical study to enhance the credibility of integrated reports through the use of insurance reports, which should be perceived as opportunities for the development of the profession. Ensuring fully integrated reports requires a set of standards and professional skills that are continually improved. This necessity is supported by the findings obtained through the development of these research methods. The obtained results clarify the importance of involving multidisciplinary teams in insurance missions and, implicitly, the need to develop new professional competencies.

### 3. ISQC1 and ISA 220

In general, communication of quality control policies includes their description and definition of the objectives for which they were designed, and the message that each individual has a personal responsibility for quality and expects it to comply with these policies and procedures. Encouraging firm personnel to communicate visions and concerns about quality control issues highlights the importance of getting a feedback on the company's quality control system [8].

The nature, duration and extent of the policies and procedures of an audit firm depend on a number of factors, such as the size and nature of its activity, geographical spread, organization and cost / benefit ratios. Auditors should use policies and procedures that comply with the standards in use. [9] Consequently, the policies and procedures adopted by individual audit firms will vary in function by the extent of their documentation as follows:



**Figure 1** - Links established between auditors' reports and audit areas

*Source: Elaborated by the authors*

However, the opportunity presented by internal auditing missions and their review, as well as the financial statements underlying them, should of course not to be avoided, of course with the exemplary use of reasoning and professional scepticism and in accordance with the standards of Professional Ethics and International Standards In the Review Engagements (ISRE).

The auditor should prepare a written report which needs to certify that the interim financial information contains a complete set of general purpose financial statements prepared in accordance with the reporting financial framework to obtain a fair presentation, a statement that the management is responsible for preparing and presenting the intermediate

financial information in accordance with the applicable financial reporting framework. The enterprise must also have a competent professional in the field in order to achieve its objectives [9].

#### **4. Statistical analysis of data from the audit sector**

Big Four published studies (such as KPMG, 2013 and 2015, or Deloitte, 2014) show that more and more companies are producing integrated reports, with an increased interest from others to address this type of reporting. Given the growing demand for integrated reporting, it is believed that in the near future there will be an insurance claim for this kind of reports. Deloitte reported in 2014 that 55% of the 250 companies selected for a study in 2014 have secured sustainability reporting, for 28% in 2012.

In the existing studies, it was extracted from the company annual reports general data about them and data regarding the content of the reports, focusing on aspects related to the insurance of non-financial information such as sustainability, social, environmental, or governance information.

Of the 98 companies surveyed, 52 are from Europe, 23 from America, 6 from Africa and 17 from Asia or Australia. 43 companies have as main activity production, the other having other types of main activities. 29 companies out of 98 include the insurance report in the integrated report. For other 6 companies, the integrated report included the insurance opinion. The result is that 35.71% of the companies surveyed have their opinion in the integrated report. This percentage is much lower than the one reported in 2013 for sustainability reports (62%).

In Asia and Australia, the percentage of companies that include the audit opinion in the annual report is the highest. The study shows that 40% of the companies that have as main activity production include the audit opinion and only 30% of the companies with other main activities include the insurance opinion. It is assumed that most of the audit missions to non-financial statements in the integrated reports are partial. The study found that 60.2% of companies do not include the audit opinion for the entire report, but only for part of the information. In 72% of the cases the insurance is partial, and only 28% of the companies ensure the full report. It results that for 11.14% of the analysed companies there is certainty that the integrated report is fully assured.

From the studies conducted, it was found that the reports issued by professionals from other fields tend to be longer, the average number of

pages being 2.45 per report, and in the case of those issued by the accounting professional for 1.65 per report.

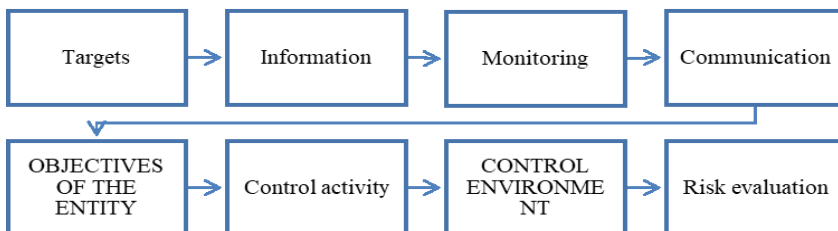
This statistical study has identified a number of issues that need to be resolved in the near future to enhance the credibility of integrated reports through the use of insurance accounts, which should be perceived as opportunities for the development of the profession. The insurance of fully integrated accounts requires a set standards and professional skills that needs to be always improved. This necessity is borne out by the findings of this research.

A serious issue of integrating reports also results from the heterogeneous nature of the information contained in these reports. The obtained results clarify the importance of interdisciplinary team involvement in insurance missions and, implicitly, the need for the development of new professional competences. Thus, traditional audit practices are regularly reoriented to keep up with the needs of executing missions in emerging areas; when these practices and competencies are overcome, audit objectives need to be redefined to meet existing needs. Also, underdeveloped technologies need to provide strong support to improve reporting.

## 5. Audit risks

Information management is appreciated as a basic resource in the company's economy. Information represents risk-shielding, knowing that a good perception of reality based on information eliminates vulnerabilities and fades the risk in all its aspects. Every business is at one time subject to risks, but by knowing them and by using information, we sought to achieve control, to an acceptable extent, to coordinate or manage them.

Audit risks are the possibility for the auditor to provide an inappropriate audit opinion due to the fact that the financial statements have been materially misstated.



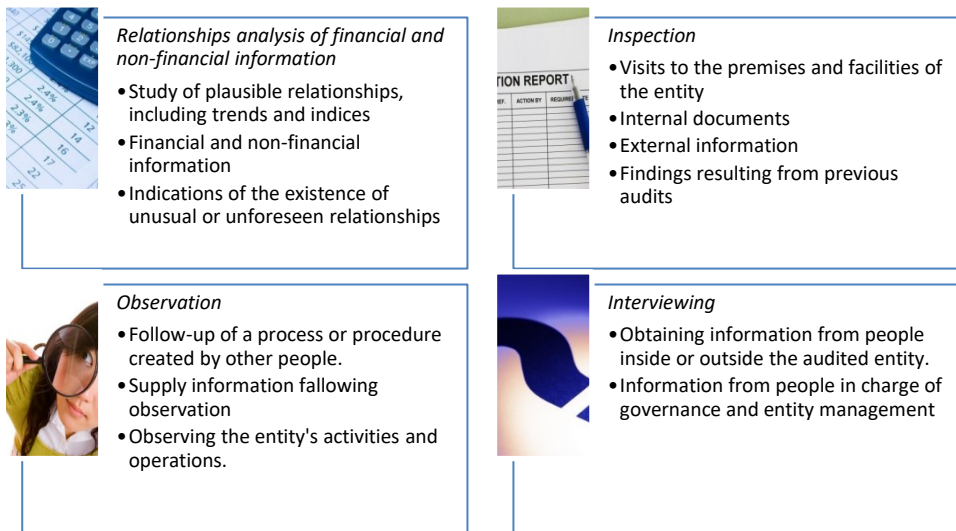
Source: Elaborated by the authors

**Figure 2** - Structure of intangible assets

The risk assessment is based on reasoning rather than on a precise measurement. The level assigned to each component is estimated by the auditor on the basis of his professional judgment based on the following procedures. In other words, the more the risk affects the management process, the more negative the impact will be. Also, the other way around, the more the risk affects the selective decision-making process on the trading segments, the more positive impact will be.

## 6. Findings

Evaluating control risk in preliminary work practically represents an assessment of the effectiveness of the entity's internal accounting and control models used to detect wrong information that has a significant role in the audited financial statements. There will always be some control risks due to the inherent limitation of any internal accounting and control system. Preliminary risk control assessment will be performed for each significant account balance or significant transaction category.



Source: Elaborated by the author

**Figure 3** - Risk assessment procedures

These risk assessment procedures are used to understand the following issues, which are examined as it follows:

- the entity and its environment, in order to identify the risks inherent in the area under review, including related party risks and fraud;



- Internal control mechanisms at each relevant level (Commission, Member State, Intermediate, Beneficiary) to facilitate identification of control risks.

In order to control and identify the ways in which audit firms perform audit missions, professional entities call for a series of control procedures organized at different stages, taking into account and examining as much as possible the relevant aspects that may influence the audit opinion. These procedures are ultimately quantified using the mathematical model below:

$$R_a = f(R_{A\alpha}; R_{A\beta}) = \frac{\prod_{i=1}^2 \cdot R_{\alpha i} \sum_{k=1}^{m_{\alpha i}} m_k + \prod_{i=3}^8 R_{\beta i} \cdot \sum_{k=1}^{m_{\beta i}} m_k}{\sum_{k=1}^m n_k}$$

where:  $\alpha, \beta$  = Audit risk indicators, inherent risk and control risk;  
 $m$  = The number of applied procedures  
 $n$  = Number of steps taken to determine the risks

The results of the inspection mission to assess the quality of the audit are shown in the table below:

**Table 1** - Results of the audit quality inspection

No	Objective /Chapter	No. of procedures	From which without risk	With risk	General risk	Score function
I	Understanding the scope of financial audit engagements and their compliance with ISAs	17	14	3	0,17	0,1923
A	General objectives	7	6	1	0,14	
B	The elements of the commitment	10	8	2	0,2	
II	Control of activity compliance in comparison with what was stated in the application for authorization to practice. Statement of income, fulfillment of obligations towards CAFR	9	7	2	0,22	
III	Analysis regarding the fulfillment of the continuous training obligations of the personnel involved in the missions	4	4	0	0	
IV	Analysis of the implementation of the quality control system used by the audit firm, and compliance with ISA and the quality of independence of the Code of Professional Ethics	19	16	3	0,31	
V	Control of the development of review procedures to ensure the quality of audit engagements of entities' financial information in accordance with ISQC1 and	6	4	2	0,67	

No	Objective /Chapter	No. of procedures	From which without risk	With risk	General risk	Score function
	the Ethical Code					
VI	Compliance with the standards for the actual progress of the audit in compliance with ISA and the Quality Audit Guidelines	74	67	7	0,18	
A	Planning the audit activity	21	19	2	0,19	
B	Performing the audit mission	44	41	3	0,13	
C	Completing the audit engagement	9	7	2	0,44	
VI I	Way of complying with the obligations established by the Decision of the CAFR Council no. 83/26 06 2016 for the enforcement of the law on combating and preventing money laundering and / or terrorist financing by auditors	2	2	0	0	
VI II	Evaluation of the content of the most recent transparency report published by the auditors / audited firms, as required by Art. 46 of OUG no.90 / 2008.	3	2	1	0,67	
	<b>TOTAL</b>	<b>134</b>	<b>116</b>	<b>18</b>	<b>0,23</b>	<b>0,2165</b>

Source: Elaborated by the authors

Applying the formula we obtained the following results:

$$f(R_{a\alpha}) = \sum_{i=1}^2 \frac{\sum_{k=1}^m X_k \cdot \alpha}{\sum_{k=1}^m n_k} = 0,1923$$

$$f(R_{a\alpha}) = \sum_{i=1}^2 \frac{\sum_{k=1}^m X_k \cdot \alpha}{\sum_{k=1}^m n_k} = 0,1923$$

Following the inspection, the overall risk based on a number of 134 procedures was determined at 0.1923% for inherent risk and 0.2407 for control risk, with 18 procedures considered to be at risk audit and 116 risk-free procedures.

We can conclude that if the quality control procedures are applied to an audit, the study confirms that the risks are very close to zero, which means that the audit mission was conducted and carried out in compliance with the quality standards in force and implicitly, the audit opinion provides reasonable assurance about the audited financial statements.

## 7. Conclusions

The environment of accounting profession is changing. We can thus identify global connectivity, newer and more powerful technologies, engines capable of influencing the global accounting needs of accountants over the years to come. Where there is a change, there is a greater need for safety in general and for audit in particular, and for audit and insurance it becomes necessary to have new ways to use these new technologies. New funding models will require new insurance services. Stakeholders expect auditors to exploit new ways of working so as to lead to greater efficiency so that reporting times are shorter and at the same time improve the quality of the audit.

In the paper we developed a risk assessment procedure based on mathematical risk equations. Following the implementation of the model, it was possible to determine the general risk based on the application of a number of 134 procedures. It was determined inherent risk to be at 0.192 and 0.2407 for control risk with 18 procedures that were considered to be at risk of audit and 116 risk-free procedures.

The paper is a valuable contribution to the systemic risk approach in auditing, quantifying and evaluating them through mathematical models whose practical applicability has been demonstrated, as well as highlighting the importance of the audit in preparing papers for accessing the Structural Funds, and especially the importance of emphasizing the specificity of the activity in determining the risk of a company.

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