

## AN ASSESSMENT OF FINANCIAL AUDIT PRACTICES IN THE ROMANIAN METALLURGICAL INDUSTRY

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The goal of this paper is to provide an assessment of financial audit practices of the largest metallurgical companies trading on Romanian capital market. Metallurgical industry represents a significant sector in the Romanian economy as a whole; therefore an evaluation of audit practices used by these companies could provide relevant information. Based on a well-documented literature review, with a focus on main findings concerning audit practices, especially in the context of corporate governance, there was selected a set of certain criteria that should be taken into consideration when referring to the best practices in the audit area.

*Key words:* metallurgical industry of Romania, financial audit practices, scoring, corporate governance

### INTRODUCTION

Until 1990, the metallurgical industry was characterised by a massive concentration and support of the state, being one of the main strategic pillars of the Romanian economy, while during communist period, Romania produced around 17 million tonnes of raw steel, of which resulted 10 - 11 million tonnes of laminated products, which is three times higher than in 2011 [1, 2].

After 1990, due to some factors such as the process of transition to a market economy, the tendency for decentralisation and privatisation of the main metallurgical plants, the decline of this major sector in the ensemble of the Romanian economy was strongly felt.

Even so, the metallurgical industry still remains one of the relevant sectors of the Romanian economy, one significant argument for this assumption being the important investment programmes that have been carried on in the metallurgical sector following to provide a major contribution at the modernisation process of production capacities for turning them to be more efficient and competitive [3].

Also, the integration process of Romania within European Union determined a careful monitoring of this sector as well, particularly from the perspective of the increasing need for enhancing the competitiveness of Romanian economy, including Romanian metallurgical industry. The process of restructuring the Romanian steel industry was the object of three monitoring reports issued by the European Commission (2006, 2008, and 2010) because the European Union authorised Romania

to provide restructuring aid designed for completing the restructuring of its steel industry [4].

### FINANCIAL AUDIT IN THE CONTEXT OF CORPORATE GOVERNANCE

The concept of corporate governance, but also the role and responsibilities of audit function in the context of corporate governance it is, definitely, one of the major points of interests at European and global level. This interest was strongly stimulated by the rapid expansion of the financial scandals that have negatively influenced some of the advanced economies, determining at the same time, an increasing pressure from the public and investors about the real efficiency of corporate governance, while one of those significant mechanisms – the audit function – has been strongly criticized [5].

According to some studies and scholar papers from the past few years, in the context of global economic crisis that is still affecting various worldwide economies for more than 4 - 5 years, the next evolution of audit practices will be more and more influenced by the links that should exist between audit, corporate governance and corporate social responsibility [6, 7].

These consequences of the latest economic and financial crisis have significantly influenced the evolution of the economies at European level, while relevant European institutions began to focus on immediately adopting the necessary measures that should be applied in order to ensure the economic and financial stability.

In this context ensuring economic stability for metallurgical industry at European level is, also, one of the major points of interests for European institutions, considering the urgent necessity to ensure an appropriate rhythm of sustainable economic development at European level.

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In the same vein, ensuring an appropriate corporate governance framework is also another subject of interests at European level. Regarding European countries, the corporate governance framework for the listed European companies is based on a set of legal provisions, including recommendations and codes of corporate governance, from which most of them are applying the principle “Comply or explain”. The code of corporate governance for most European countries are adopted at national level, but EU Directive 2006/46/CE strongly recommends the applying of the provisions of these codes, requiring the listed entities to clearly justify the applying or non-applying for some of the corporate governance codes’ provisions.

In this range of challenges to build an effective corporate governance framework, an important role is assigned to the financial auditor, which due to his position and responsibilities he must assume, and starting from the premise that he should have a good knowledge of the applicable accounting rules, the auditor could provide a reasonable assurance to investors about the effectiveness of managing the economic and financial transactions of the company [8].

In order to provide a framework for effective corporate governance, the assessment of financial audit practices is more relevant as it is taken into account the primary responsibility of the financial auditor, who through his opinion must provide a reasonable assurance whether the financial statements are free from material misstatements and whether the financial statements give a true and fair view about the financial position and performance according to a well established set of accounting standards [6].

The significance of financial audit practices in the field of monitoring and corporate governance in order to ensure the financial stability is also recognised at European level, one relevant argument in this direction being the report issued by the European Commission, in which it is stipulated the role of the financial audit for ensuring the “*veracity of the financial health of all companies*”, while “*robust audit is key to re-establishing trust and market confidence; it contributes to investor protection and reduces the cost of capital for companies*” [9].

## RESEARCH DESIGN

### Objective of the study

The main objective of the study was given by the necessity of obtaining a global view about the quality of financial audit practices used by entities in Romanian metallurgical entities, considering the importance still major of this sector in the Romanian economy as a whole.

### Sample selection

The sample used within this study included companies in the metallurgical industry that on the 2012 year-

end have been audited according to legal provisions. According to the provisions of Order of the Minister of Public Finances no. 3055/2009 for the approval of accounting regulations in accordance with the European Directives and the Law of accounting no. 82/1991, the companies that should be audited are the entities that, at the end of the last two preceding years, surpass two of the following three criteria:

- Turnover over 7,3 mil. €.
- Total assets over 3,65 mil. €.
- Average employees number over 50 [10].

Also, another criteria for including companies in the sample, was given by the existence of minimum required information on their website. Considering also the requirements of the national Corporate Governance code issued by Bucharest Stock Exchange (BSE) for more transparency, it’s become obvious that the final sample should include only listed metallurgical companies. Starting from the availability of the necessary data for the proper assessment of financial audit practices, the final sample is given by the entities presented within Table 1.

Table 1 **Sample used**

Bucharest Stock Exchange (BSE)	Romanian Association of Securities Dealers Quotation (RASDAQ)
<ul style="list-style-type: none"> <li>▪ Alro S.A. (<b>ALR</b>)</li> <li>▪ Alumil Rom Industry SA (<b>ALU</b>)</li> <li>▪ Cos Târgoviște S.A. (<b>COS</b>)</li> <li>▪ Tmk-Artrom SA (<b>ART</b>)</li> </ul>	<ul style="list-style-type: none"> <li>• Arcelormittal Tubular Products Iași SA (<b>TPRO</b>)</li> <li>• Dan Steel Group Beclean (<b>PRMT</b>)</li> <li>• Galfinband SA (<b>GALF</b>)</li> <li>• Mechel Câmpia Turzii S.A. (<b>INSI</b>)</li> </ul>

### Data

In order to assess the financial audit practices used by companies from the metallurgical sector in accordance with the scoring based on a well documented literature review in the field, for each company selected the data source was represented by the reports disclosed on their own website such as: directors’ annual reports, financial reports, documents for General Meetings, sections of Corporate Governance, statements “Comply or explain” and any other useful documents presented on the company’s website. All the documents and financial statements consulted within this study were referring to the financial year 2012 for all of the companies sampled.

### Methodology

In order to provide a relevant assessment of the financial audit practices used by metallurgical companies from Romanian economy, it was developed a scoring for evaluating audit practices. The criteria included in this scoring were synthesized as a result of the background literature that revealed the best practices for financial audit in the context of corporate governance.

*The external audit practices scoring (Max = 29)* reflects the quality of financial audit practices used within the metallurgical companies. This scoring is constructed by combining the following x sub-scorings:

- ❖ *Criteria 1:* Auditing of financial statements
- ❖ *Criteria 2:* Written certification of financial auditor's independence
- ❖ *Criteria 3:* Monitoring of the financial auditor's independence
- ❖ *Criteria 4:* The applying of certain necessary criteria for the financial auditor's independence
- ❖ *Criteria 5:* Providing consulting activities by the financial auditor
- ❖ *Criteria 6:* Possibility of further employment of the independent financial auditor within the company
- ❖ *Criteria 7:* The financial auditor's selection
- ❖ *Criteria 8:* The financial audit's role and responsibilities
- ❖ *Criteria 9:* Financial audit services provider
- ❖ *Criteria 10:* The audit opinion
- ❖ *Criteria 11:* Financial audit findings
- ❖ *Criteria 12:* Audit fees
- ❖ *Criteria 13:* Provision of non-audit services
- ❖ *Criteria 14:* The relationship between financial audit and audit committee.

## RESULTS AND DISCUSSIONS

All the metallurgical companies included in the final sample are using the "one-tier" as type of leadership structure. For the entities listed on primary market (BSE) the corporate governance statement "Comply or explain" for financial year 2012 is disclosed, while for the other 4 entities listed on secondary market (RASDAQ) the corporate governance statement is not disclosed. For all metallurgical Romanian companies listed on BSE (n = 4) where corporate governance statement was disclosed it was observed partial compliance, but deviations are explained. Further on within Table 2 it is presented the scoring of financial audit practices assessed for every sampled metallurgical company.

It is important to mention that this scoring used for evaluating the financial audit practices, is trying to incorporate the best practices in this field, not only the minimum information required by legal provisions, because in the authors' vision, not always a comprehensive legal framework realises to exhaustively incorporate the best practices.

The results presented in the above displayed table revealed that the maximum scoring of financial audit practices is obtained by two entities listed on BSE primary market (ALR=13; COS=15). Even so, for both of these two companies the scoring obtained is quite far from the maximum scoring that could be obtained according to the established methodology (Max = 29), which could reflect the fact that financial audit practices used in Romanian metallurgical sector are currently quite far from being in accordance with the best practices in this field.

Further on, proceeding to a detailed analysis on the elements of scoring, it is important to emphasize some of the "hotspots" in terms of financial audit, correlated

Table 2 **Scoring of financial audit practices for sampled metallurgical entities**

Company Scoring	Bucharest Stock Exchange (BSE)				Romanian Association of Securities Dealers Quotation (RASDAQ)			
	ALR	ALU	COS	ART	TPRO	PRMT	GALF	INSI
Criteria 1	1	1	1	1	1	0	1	1
Criteria 2	0	0	0	0	0	0	0	0
Criteria 3	0	0	1	0	0	0	0	0
Criteria 4	0	0	0	0	0	0	0	0
Criteria 5	0	0	0	0	0	0	0	0
Criteria 6	0	0	0	0	0	0	0	0
Criteria 7	1	0	1	1	1	0	1	1
Criteria 8	5	3	4	4	4	0	4	4
Criteria 9	1	1	1	1	1	1	1	1
Criteria 10	3	3	2	2	3	0	3	2
Criteria 11	0	0	0	0	0	0	0	0
Criteria 12	0	0	0	0	0	0	0	1
Criteria 13	0	0	5	0	0	0	0	0
Criteria 14	2	0	0	0	0	0	0	0
<b>Total scoring</b>	<b>13</b>	<b>8</b>	<b>15</b>	<b>9</b>	<b>10</b>	<b>1</b>	<b>10</b>	<b>10</b>
<b>Average scoring of financial audit for metallurgical sector</b>								
<b>9,5</b>								
<b>Average scoring of financial audit for total Romanian market</b>								
<b>14,26</b>								

Source: own projection

with the principles of corporate governance, hoping that these could represent a good starting point for launching concrete debates about the improvements that are necessary for audit practices in Romanian metallurgical sector.

Thus, some of the weaknesses of financial audit practices in Romanian metallurgical sector are given by at least:

- too little information disclosed about the criteria applied for ensuring the independence of financial auditor's independence.
- less information disclosed about the possibility of further employment of the independent financial auditor within the company. Particularly, for countries with a german legal system, it is strongly recommended the prohibition of the financial auditor in management positions of the audited society for a certain period of time.
- less information disclosed about the audit fees. Considering the necessity of transparency in the context of corporate governance, only one company from a total of eight analyzed disclosed the audit fees for financial auditor.
- less information about the provision of non-audit services. At global level it is strongly recommended that providing some consulting or other non-audit services by the same auditor that provides financial audit of the financial statements to be limited to a certain level, in order not to influence its independence.
- Finally, less information about the relationship that exists between the financial auditor and the audit com-

mittee/board of directors, this relationship being important especially in the context of corporate governance.

## CONCLUSIONS

Comparing the average scoring of financial audit for the metallurgical sector (9,5) with the average scoring of financial audit practices for all the companies listed on the Romanian capital market (14,26) [11], but also comparing it with the maximum potential scoring (29), one conclusion is clear: that the metallurgical sector clearly needs improvements for audit practices as well, in order to ensure its efficiency and competition, particularly for a national economy such as the Romanian one.

The authors admit that a future challenge will be to look for potential solutions that might have a real contribution to the overcoming the difficulties that might strongly influence the evolution of the metallurgical sector, and certainly, one of these challenges will be given by the necessity to enhance the audit practices applied in this field.

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**Note:** The responsible translator for English language is the lector from Faculty of Economics and Business Administration, Babeș-Bolyai University, Cluj-Napoca, Romania