

CHAPTER 1

GRADUAL CHANGE OF THE FUNDAMENTAL PURPOSE OF AUDIT SERVICES



- 1.1. Introduction**
- 1.2. Audit history to date**
- 1.3. Audit reform by introducing the national POB inspections**
- 1.4. Qualitative research: interviewing the auditors regarding the existence and the resolution of the ethical dilemmas in auditing**
 - 1.4.1. Research methodology*
 - 1.4.2. Data analysis process*
 - 1.4.3. Research results*
- 1.5. Conclusions and personal considerations**

1.1. Introduction

The first chapter of this postdoctoral thesis entitled *The gradual change in the fundamental purpose of audit services* is not intended to be a boring history course, but rather a record of the events that have marked the history of auditing, since the change in the fundamental purpose of audit services until the gradual reformation of the audit field. Without an incursion in time, with the help of specialized literature, I believe that it is not possible to research and record the root of financial frauds, respectively the source of ethical dilemmas that have as limits legality and morality in the field of audit services.

Like the structure, Chapter 1 comprises five equally weighted parts that aim to trace the most important events that have reformed auditing field to date. After a short introduction on the central topic, the second sub-chapter substantiates the theoretical foundations of the audit over time, pointing out the criteria that led to the change over time in the fundamental purpose of the audit services. The third sub-chapter records the reform of the audit by introducing national POB inspections, as well as the importance of the harmonization of the POB inspection plan at the level of EU countries by the CEAOB. The next sub-chapter develops a qualitative research that brings to the fore the recording of a sample of 10 interviewed auditors with managerial or executive functions. The conducted interviews confirm, once again, the existence of ethical dilemmas in auditing, but also bring an element of novelty regarding the lack of uniformity in reporting related to the POB authorities at the EU level. Also, the research methodology, the data analysis process and the results of the qualitative research are recorded, as well as their dissemination in the specialized literature. Finally, the conclusions and personal considerations of the author are drawn.

1.2. Audit history to date²

The term *audit* (Oxford English Dictionary, 2025) comes from the Latin language *audire* being translated by the verb *to listen* or *pass on* and from the French language *ex-abrupto* and it means *listening to the accounts*.

Over time, the specialized literature (Boyd, 1905) records that the history of auditing was written, in the first phase, by ancient civilizations. Dobroțeanu

² Article *Why change over time the fundamental purpose of auditing?*, Tache, M., IJBMI, 2023, 12(9), p. 82-85.

and Dobroțeanu (2002) believe that the accounting records belong to the Assyro-Babylonian civilizations, which are closely related to trade activity (Code of Hammurabi). Their concern to have an accounting record related to the collection of taxes, receipts or payments is even an intrinsic part of the control or verification techniques, including audit techniques, which have as their fundamental purpose the reduction of fraud and errors recorded by certain officials. Some authors (Olagunju & Owolabi, 2021) attest that, in the 5th century, in Ancient Greece and, later, in the Roman Empire, there was talk of auditing the accounts that had to be carried out at the level of public funds. Other sources (Boyd, 1905) record that the earliest forms of auditing were found in the ancient civilizations of China, Egypt, and Greece. Until the 16th century in London, the auditing technique (Fitzpatrick, 1939) aimed at verifying transactions and highlighting the degree of honesty and sincerity of the people responsible for those documents.

Until the 18th century, the audit was ordered only by monarchs, the church and the state to punish thieves and preventively to protect the heritage of the state or the organization (Crotenco & Telembeci, 2015). For a short period of time (Crotenco & Telembeci, 2015), these people were justiciable with the punishment of thieves, and daredevils with the protection of the state's patrimony precisely because of the intrinsic moral qualities related to the positions they held (Tache, 2022). Other sources (Fung et al., 2009) attest that, during the reign of Henry I (1100-1135), to prevent fraud, audit officers examined the revenues and expenditures of the state, they were appointed by the British Treasury. Established authors (Fitzpatrick, 1939) state that the objective of auditing is to verify the honesty of taxpayers, so in 1394, in the Italian city of Pisa, an accountant was given the task of checking the accounts of government officials in Venice to detect possible existing fraud. During that period, audit expenses were determined according to the number of errors or the extent of the fraud (Brown, 1962). The increase in the complexity of business has led to the development of accounting practices, so that the use of double entry in accounting is of Italian origin. Merchants in Florence or Genova employed auditors only to assist in certain checks on ships, so the objective of the audit remains unchanged, namely, to prevent fraud.

Over time, through the establishment of manufacturing enterprises or the development of corporations, the number of financial failures inherent in an unregulated market led to the discrediting of their management (Brown, 1962). Thus, the industrial revolution (Porter, Simon & Hatherly, 2005) determined the

legitimization of audit services, given the fact that industries, at that time, were deprived of any external connection, because they were managed on an individual level (Porter, 2005). During the same period, the stock market was unregulated, and the rate of financial failure increased enormously, and investors needed the protection provided by the auditing profession. Thus, large-scale operations consolidated the large corporations resulting from the establishment of manufacturing enterprises.

The Industrial Revolution constitutes a radical change in the accounting system, namely the standardization of accounting and the verification of accounting by persons independent of the management of the company (Tache, 2021). Gradually, auditing begins to be sought after more and more, from the detection of fraud and errors to its legitimization as an activity.

In Britain, this revolution consolidated the practice of auditing (Ricchiute, 1989). Gradually, the independence of professionals to control the correctness of financial statements becomes more and more useful to managers, and after the middle of the 19th century, the audit acquires new valences in the economy. In 1844, Britain passed the Companies Act, which required company directors to employ auditors to oversee the company. By Companies Law no. 1862/UK (Companies Act of UK, 1862), Great Britain regulated the statutory audit through the annual presentation of the balance sheet by the shareholders (Leung, Coram & Cooper, 2007). At that time, the manager was the accountant, and the auditor was the shareholder. Between the 18th century and the first half of the 19th century, auditors were chosen from accountants, and states, courts, and shareholders commissioned auditing services. At the end of the 19th century, auditors, chosen from among accountants, checked the accuracy of financial statements to blur out errors and fraud (Gaddis, 2018). As a guarantee of all large-scale operations, the legislation of the audit profession and audit services was presented as a real protection of internal and external investors. Thus, during that period, the audit maintained the integrity of the state's patrimony and of private and public entities. In the matter of audit, the deficiencies of the 19th century were due to the non-existence of an unanimously accepted normative framework, respectively the non-existence of audit procedures. Thus, by the Commercial Companies Law, the primary objective of the audit is the verification of financial statements (the balance sheet), and the secondary objective is the prevention and discovery of errors and economic fraud.

As we can see, the basis of auditing practices is of British origin, being a model for the further development of the auditing profession in the United States

of America. British influence did not persist among American auditors, as American auditing brought significant influence to auditing techniques globally. As an example, introducing audit tests, sample verification, testing the internal control system and capitalizing on the link between internal control and audit practices. Moreover, the concept of audit engagement was introduced in 1917 by the American Institute of Accountants. Starting with the year 1930, the fundamental objective of audit services was legislated, namely, the certification of financial statements. Later, the decision of the New York Stock Exchange from 1933 legislates the obligation to certify the financial statements by an independent accountant, respectively the existence of the audit report prepared by an independent auditor.

The first part of the 20th century was characterized by prosperous changes in the American market, and the size of companies led to the separation of ownership and management functions. Therefore, the audit function has changed, giving credibility to the financial statements presented by the directors to the shareholders of the companies. Thus, the responsibility of the audit has changed, from detecting fraud to ensuring the honesty of the preparation of financial statements. The concept of audit materiality (Queenan, 1946), or the materiality threshold, was used in conjunction with sampling techniques while corporations were involved in large transactions. Baxter (Baxter, 1999) attests that two financial scandals, the Royal Mail entities (1931) and McKesson and Robbins (1938), brought about major changes in the world of auditing. The introduction of the Profit and Loss Account audit became mandatory in America in 1934 and in the United Kingdom in 1948 (Teck-Heang, 2008).

The main features of the audit approach at that time included, among others: (i) reliance on the company's internal control and sampling techniques used; (ii) audit evidence collected from both internal and external sources; (iii) emphasis on the truth and correctness of financial statements; (iv) the gradual passing of the audit of the Profit and Loss Account, provided that the balance sheet remains an important document; and (v) physical observation of external evidence and other evidence, other than accounts (Porter, 2005). The audit scope included banking and financial institutions. This period was exacerbated by an increase in international trade.

The second half of the 20th century was influenced by the auditor's role in increasing the credibility of financial statements. Over time, as the size and transactions of firms increased, auditors increasingly used internal control reports from firms to support audit engagements. If this type of internal control was effective, auditors reduced substance testing. Beginning in 1980, auditors began

to apply analytical procedures due to the high costs of the company's internal control. Turley and Cooper (1991) confirm risk-based auditing, which emphasized that auditors controlled the areas where errors were most common, and this key aspect was known only by studying the company, policies and industry. This period was marked by computer systems that monitored and controlled operational and administrative processes, but also by the simultaneous provision of consulting services to audit firms. Thus, the role of the auditor was gradually associated with the role of financial consultant (Gaddis, 2018).

Since the 1990s, the auditor's role (Teck-Heang, 2008) has increased by entrusting him with several functions, namely, monitoring operational processes, administrative control, up to consulting services. The period 1990 to the present has been characterized by sudden changes in the economy that have intrinsically led to accelerated changes in the world of auditing. Concretely, the concept of risk is the main factor alongside the notions of significance and relevance that appear, in the foreground, in audit missions (Volkova et al., 2017). Since the early 1990s, the audit profession has begun to assume greater responsibility in detecting and reporting fraud, as well as in more explicitly assessing and reporting doubts about the auditee's ability to continue as a going concern. the applicable regulations. Since 2000, the goal of audit firms continues to increase the credibility of financial and non-financial information in annual reports. The consulting services provided by the same companies that audit the financial statements have for several years generated higher revenues than those resulting from auditing activities, and the quality of the audit has begun to be questioned due to the major scandals in American history. The collapse of these corporations led to a crisis of confidence in the auditor's work (Boynton & Johnson, 2006). Moreover, a series of radical reforms were undertaken in various countries by accounting bodies or stock exchange commissions (SECs) to strengthen auditing practice, and the Sarbanes Act- Oxley (2002) expanded the auditor's duties by verifying internal controls over financial reporting (Tache & Caloian, 2023).

Until now, audit services have the role of increasing the credibility of the respective financial statements and the non-financial statements related to the annual reports. The accounting bodies (International Standards of Auditing: ISA, English) and the US Securities and Exchange Commission (SEC, English) represent radical changes in the auditing world. Also, the Sarbanes-Oxley Act (2002) culminates and completes the multitude of legislative changes inherent in globalization.

Thus, the audit aims to determine the degree of fidelity related to the financial statements of an entity and the application of test procedures to be able