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# Why change over time the fundamental purpose of auditing?

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***ABSTRACT:*** *This paper analyzes at the theoretical level, the gradual change in the fundamental purpose of auditing moving from the prevention and discovery of the respective errors of economic fraud to the attestation of the credibility of financial statements. Even if the fundamental purpose has changed, auditing begins to be sought after more and more, from the detection of fraud and errors to its legitimization as an activity in its own right. Since the 1990s, the auditor's role has increased by entrusting him with several functions, namely, monitoring operational processes, administrative control to consulting services. Thus, the primary purpose of the audit became its secondary objective, which gradually led to the trivialization of audit services. Therefore, where are we heading? Perhaps we should see some possible reasons behind this change so that the visible result is none other than a massive increase in financial fraud. Through a foray into time, we want to see what are the reasons for the change over time in the purpose of audit services and the result of this change.*
***KEY WORDS:*** *auditing, ethical dilemmas, history, trivialisation.*

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## I. INTRODUCTION AND LITERATURE REVIEW

The term *audit* 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 records that the history of auditing was written, in the first phase, by the ancient civilizations (Boyd, 1905). Historians believe that the accounting records belong to the Assyro-Babylonian civilizations, which are closely related to trade activity (Code of Hammurabi) (Dobroţeanu & Dobroţeanu, 2002). 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 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 (Olagunju & Owolabi, 2021). Other sources record that the earliest forms of auditing were found in the ancient civilizations of China, Egypt, and Greece (Boyd, 1905). Until the 16th century in London, the auditing technique aimed at verifying transactions and highlighting the degree of honesty and sincerity of the people responsible for those documents (Fitzpatrick, 1939).

Until the 18th century, the audit was ordered only by monarchs, the church and the state in order to punish thieves and preventively to protect the heritage of the state or the organization (Crotenco & Telembeci, 2015). For a short period of time, 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 attest that, during the reign of Henry I (1100-1135), in order to prevent fraud, audit officers examined the revenues and expenditures of the state, they were appointed by the British Treasury (Fung et al., 2009). Establised authors 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 (Brown, 1962; Fitzpatrick, 1939). During that period of time, audit expenses were determined according to the number of errors or the extent of the fraud. The increase in business complexity 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 Genoa 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 a properly unregulated market led to the discrediting of their management (Brown, 1962). Thus, the industrial revolution 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

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individual level (Porter et al., 2005). During that time, 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 production enterprises (Brown, 1962). 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 its own right.

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 no. 1862, English), Great Britain regulated the statutory audit through the annual presentation of the balance sheet by the shareholders (Leung et al., 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 a 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 (accounting 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, or the materiality threshold, was used in conjunction with sampling techniques at the same time that corporations were involved in large transactions (Queenan, 1946). 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 et al., 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 of time 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).

With this, the primary objective of the paper ist o identify the gradually changes of the fundamental aim of auditing that can either can affect the audit services. Therefore, the structure of the paper is organised as follows. Section I of the paper introduces the history of audit history and it tries to justify the possible reasons behind the study through a brief review of literature. Section II clearly emphasizes the consequences of changing the fundamental scope of auditing. Finally, Section III interprets the findings and it concludes the present research.

## II. The consequences of changing the fundamental scope of auditing

The auditor's role has increased by entrusting him with several functions, namely, monitoring operational processes, administrative control, up to consulting services (Teck-Heang et al., 2008). 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 et al., 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 (Tache & Caloian, 2023).

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 to discover certain errors or fraud (Roussy et al., 2020). Ultimately, as companies have developed, the role of auditing is no longer to detect fraud and error, by verifying the honesty of those people responsible for the administration/management of other people's wealth (Christ et al., 2021). On the contrary, the audit verifies and certifies the conformity of the financial statements. Concluding the above, we highlight the evolution of audit services over time from an exhaustive verification of transactions to a sample verification (including the internal control system), thus increasing the credibility of the audited financial statements.

Before concluding this research, I propose to highlight some definitions drawn by certain authors in the specialized literature, which summarize the entire history of the audit field until now. Over time, several definitions for audit have been recorded in the specialized literature, of which I summarize in Figure 1 the definitions that most accurately encompass the gradual change in audit services. This list is not compiled in an exhaustive order, so this list emphasizes how the fundamental purpose of audit services has gradually changed.

*Figure 1:* The purpose of audit services recorded in the specialized literature

| Literature review | Definitions |
|---|---|
| Littleton(1933) | *„a check on the honesty of those charged with fiscal rather than managerial responsibility"* |
| Flint (1988) | *„account verification technique"* |
| Flint(1988) | *„a politically neutral audit technique"* |
| Reckers (2007) | *„a static activity of controlling the image of a company"* |
| Oussii (2019) | *„the control mechanism of a company, and its main purpose is to reduce agency costs"* |
| Power (2000) | *„a means of social control, being a mechanism for monitoring the managerial performance of a company"* |
| Hussain (2020)<br>Tache (2021) | *„a real trivialization of audit services, i.e. a social phenomenon that has no purpose or value, except for its practical and utilitarian usefulness"* |

*Source: Own representation*

In this regard, even if there is emphasized only some opinions from the literature review, it can be seen from the exposed definitions the gradual state of auditing nowadays. In other words, the banalisation of audit services can be perceived as one of the causes of shifting the fundamental scope of auditing or maybe a lack of trust in the audit profession taking into consideration the huge number of financial frauds.

## III. Finding and Interpretation

Concluding the information above, the gradual change in the fundamental purpose of audit services can only be analyzed at a theoretical level, moving from the prevention and discovery of the respective errors of economic fraud to attesting the credibility of financial statements. Thus, the primary purpose of the audit became its secondary objective, until the trivialization of audit services. Therefore, where are we heading? Perhaps we should see what should be the reasons behind this change so that the visible result is none other than a massive increase in financial fraud. Also, perhaps the replacement of the fundamental purpose with a simple objective is aimed at the attempt of some human minds to trivialize the audit, and to minimize its value to its maximum inefficiency as can be perceived by some internal or external users taking into consideration the increased number of financial collapses. However, the relationship between the numer of financial crimes and the last reforms in auditing can be further studied through an empirical work and thus pave the way for another research.

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