Chapter 14

The Concept of Corporate Reporting and Audit Quality

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ABSTRACT

The responsibility of auditors is a controversial topic that has brought much debate amongst academ- ics and experts alike in recent years. This chapter’s aim is to set the framework in which audit reporting exists: part of the wider landscape of corporate reporting and the final fragment of the sphere of the financial statements audit quality. By using a general-to-specific deductive approach, the authors discuss the international and European perspectives on the process of financial statement audits, as well as the stakeholders or audit and audit reporting, in order to clearly define the regulatory space in which any changes in this field occur. The authors also discuss the theories that explain the process of audit reporting, with an emphasis on the lending credibility theory, the inspired confidence theory, and the sociology of education theory. The authors consider that these theories explain the improvements undertaken to improve the communicative value of the audit quality.

INTRODUCTION

As a consequence of the international financial crisis and financial scandals, the audit report has recently been in the attention of standard setters and regulators, but also under the scrutiny of the public and third-party users. The introduction of revised regulations, focusing on increased disclosure requirements within the audit report has led, in turn, to an increase in the transparency level of the report.

Audit reporting is an important subject for the accounting and audit research field, due to its influence in the decision-making process that involves the stakeholders that rely on audited financial situations.

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Some stakeholders consider that the auditors could disclose more information that they gather regarding the audited company, within the audit report. Other users of the report consider that the language the auditors use is too standardised and the fact that the reasoning behind the issued opinion is not sufficiently explained is unsettling for stakeholders who consider the auditor should communicate more aspects. These aspects are the reason behind the revision process the IAASB has started, with the purpose of clarifying auditing standards, especially those concerning audit reporting and audit quality. The process comes as a response to stakeholders’ expressed needs and hopes to fulfil this necessity. These changes plan on improving and covering any deficiencies, but even so, the usefulness and efficiency of these proposals are being questioned.

THE CONCEPT OF CORPORATE REPORTING

Corporate reporting is the concept that connects the company to its stakeholders. Audit reporting is part of corporate reporting, along with financial reporting, corporate governance, corporate responsibility, integrated reporting and others.

Taking these elements into account, the objective of the chapter is to set the framework of audit reporting, as part of the larger sphere of corporate reporting, while analysing its strong link to corporate governance and, in particular, to the transparency principle. By using a general to specific deductive approach, we start our analysis from the concept of corporate reporting, taking into consideration the insights provided by academic research and professional organisations. Another part of this chapter is to provide a starting point to auditing theories that explain the objectives and outcomes of our research.

Corporate reporting is a company’s means of communication with stakeholders, as part of their accountability and stewardship obligations (FEE, 2015). The meaning of corporate reporting is in a continuous transformation, as Professor Mervyn E. King posits: “corporate reporting is not what is used to be” (Centre for Tomorrow’s Company, 2011). Some possible explanations for this statement are exposed subsequently. The economic world has changed in the last decade. Financial scandals have had an adverse effect on the confidence and perception of the stakeholders regarding the figures provided by reports – financial and audit reports equally. Around 80% of investors are looking for better reporting quality, because the company’s reporting quality has an unswerving impact on their investment decisions (PwC, 2014). Thus, although the auditor still focuses on the financial statements, whether they provide a “true and fair view of the company’s financial position, the communicative value of the audit report has significantly improved in recent years. And it is all because of the trend of changes in the corporate reporting framework, with the purpose of better fulfilling the needs of stakeholders.”

A first step is to define a corporation, the governance process, and corporate governance. Corporations, in a more reduced organisational size from that what they are today, have existed since the beginning of the Medieval ages (Berman, 1983) and then evolved in the 18th and 19th centuries into a more modern organisation, given the rise of classical liberalism (Smith, 1776) and the development of company laws. Followed by a deregulation period, the beginning of the 20th century saw the development of corporate legislation and the evolution into what corporations are today. A corporation can be defined as “a large company or group of companies authorised to act as a single entity and recognised as such in law” (Oxford Dictionary). We consider that this definition, while clear, is not sufficient to fully explain what a corporation is, and more importantly, it does not explain its connection to the world in which it exists. A corporation cannot exist without its stakeholders, as it must “relate to society”, therefore connect
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